九州大学
KYUSHU UNIVERSITY

GRANT OF INJUNCTION AGAINST LETTERS OF CREDIT: AN EXAMINATION OF SCOPE UNDER ENGLISH AND INDIAN LAWS

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Student ID:	2LA17051K
Name:	SEWAK, Hersh
Supervisor:	Pejovic, Caslav
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Abstract

This thesis examines the scope of injunction against payment of letter of credit under English and Indian jurisprudence. The payment / finance instruments that employ the principles governing letters of credit constitute about 62% of payment obligations in international trade. Thus, their importance and relevance to international trade remains enduring for last century. The two jurisdictions considered in this thesis are leading economies in the world. Both the countries are common law jurisdictions and have evolved their jurisprudence from same set of legal principles. The thesis focuses on the question as to how and when the Courts would intervene in preventing the payment obligations arising under such instruments.

The English law in last century has remained the focal point for study of letter of credit jurisprudence. This is on account of certainty afforded by the law as well as large share of international finance relying upon English banks or employing English law to govern their transactions.

Indian law has also borrowed from the very same starting point as the English law. However, in last forty or so years, it has evolved a distinctly different set of tests and formulations. This becomes important as India embarks upon a development policy where international trade is expected to play an increasingly larger role. Thus, the evolution of the jurisprudence as well as discussion on its current state is relevant and timely.

The thesis examines the scope under which the Courts in these two jurisdictions will interfere with payment obligations by discussing various principles and tests evolved by the Court. Also, it will reflect upon the extent of each of such principles.

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DEDICATED TO MY MOTHER

MRS. SUREKHA SEWAK

– WHOSE PRESENCE, LOVE AND UNWAVERING BELIEF –

MADE EVERYTHING POSSIBLE.

THANK YOU.

INTRODUCTION

The root of the word 'credit' is credo, the Latin for 'I believe'.[1]

"Virtuous circles result in social equilibria with high levels of cooperation, trust, reciprocity, civic engagement and collective well-being… Conversely, the absence of these traits in the uncivil community is also self-reinforcing."[2]

I. PLACE OF THE BANKS IN TRADE

Banks offer multiple facilities to its customers: ranging from safe-keeping of deposits, advancing loans, enabling mortgages, executing payments, engaging in foreign exchange payments, discounting, negotiating commercial documents and providing commercial credit. In this manner, functioning of an economy is heavily dependent upon the banks. As every commercial transaction has an element of trust embedded in it, it is necessary for the smoother functioning of the economy that these transactions inspire confidence[3]. Thus, the trust in the bank's promises is crucial for the parties engaged in trade[4].

In other words, the system of credit underpinned by bank transforms this trust into "formal, objective, measurable and social, relationship"[5]. In turn, parties can devote greater resources to commercial activities instead of protecting themselves while conducting financial

[1] Niall Ferguson, *The Ascent of Money: A Financial History of The World* (New York: The Penguin Press, 2008), 30

[2] Robert D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*, (Princeton, New Jersey: Princeton University Press, 1993), 177

[3] Kenneth J. Arrow, "Gifts and Exchanges", *Philosophy & Public Affairs* 1, no. 4 (1972): 357

[4] Costas Lapavitsas, "Information and Trust as Social Aspects of Credit", *Economy and Society* 36, no. 3 (2007): 418; Boris Kozolchyk, "Bank Guarantees and Letters of Credit: Time for a Return to the Fold", *U. Pa. J. Int'l L.* 11 no. 1 (1989): 3

[5] Costas Lapavitsas, "Information and Trust as Social Aspects of Credit", *Economy and Society* 36, no. 3 (2007): 418

transactions[6]. In societies that display low interpersonal trust, institutional reforms that provide for reliable enforcement to access to credit are even more important[7].

When parties engage in trade of goods or services for future payments, trust plays the role of cementing the belief among the trading parties that the banks will not expropriate their assets or renege on the payment[8]. Rather, economic prosperity due to engagement in financial contracts between parties is greater among the societies displaying greater levels of trust[9]. This is not just true for high volume transactions, but even, for microfinance where reliability in the banking is seen to create trust in the society[10].

To put it simply, engagement in trade is about exchange of goods or services for a future delivery of payment. And this is dependent "not only on the legal enforceability of contracts, but also on the extent to which the financier trusts the financee"[11]. In this manner, banking broadens trust among the trading parties and its role becomes that of persuading the

[6] Stephen Knack and Philip Keefer, "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation", *The Quarterly Journal of Economics* 112, no.4 (1997): 1252

Stephen Knack and Philip Keefer, "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation", *The Quarterly Journal of Economics* 112, no.4 (1997): 1258

[8] Stephen Knack and Philip Keefer, "Does Social Capital Have an Economic Payoff? A Cross-Country Investigation", *The Quarterly Journal of Economics* 112, no.4 (1997): 1252

[9] Luigi Guiso et al, "The Role of Social Capital in Financial Development", American Economic Review 94, no. 3 (2004): 527

[10] Asif Dowla, "In Credit We Trust: Building Social Capital by Grameen Bank in Bangladesh", Journal of Socio-Economics 35 (2006): 103

[11] Luigi Guiso et al, "The Role of Social Capital in Financial Development", American Economic Review 94, no. 3 (2004): 527; Costas Lapavitsas, "Information and Trust as Social Aspects of Credit", *Economy and Society* 36, no. 3 (2007): 427

transacting parties that bank's promises of payment will be honored[12]. In simple words, when push comes to shove, banks will pay what is owed.

II. LETTER OF CREDIT: 'LIFEBLOOD OF COMMERCE'

Banks play a central role when sale and purchase of goods take place. This is necessitated by an increase in the trade of goods and services in the form of a need for a verifiable intermediary that can assure payments. The banks act as such intermediary where they assure the parties of payment. One of the leading means of such payment are letters of credit[13] with the trust accorded to them has led to an unprecedented expansion in their use by the trade[14]. The trust in these instruments lies in the fact that it is a binding obligation by the bank to pay to the beneficiary when certain conditions precedent already set by the applicant is fulfilled in form of presentation of complying documents[15]. In other words, documentary credit is treated as equivalent of cash[16]. It is for this trust that it inspires among the parties that the English Courts and later, Indian Courts have called them 'the lifeblood of commerce'[17].

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[12] Costas Lapavitsas, "Information and Trust as Social Aspects of Credit", *Economy and Society* 36, no. 3 (2007): 428

[13] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 387: The expression 'letter of credit' and 'documentary credit' are used interchangeably in the trade.

[14] Boris Kozolchyk, "Bank Guarantees and Letters of Credit: Time for a Return to the Fold", *U. Pa. J. Int'l L.* 11 no. 1 (1989): 4, Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 387

[15] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 387; Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001) 1-03

[16] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 255

[17] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 388; Harbottle v National Westminster Bank QB 146 (1978); Edward Owen v. Barclays Bank 1 QB 159 (1978); National Infrastructure Development Company v. Banco Santander EWCA Civ 27 (2017); United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985); Centax v. Vinmar AIR SC 1924 (1986)

In this way, a letter of credit is a promise by the bank to the beneficiary to make the payment upon presentation of documents stipulated in the letter of credit. The Uniform Customs and Practice for Documentary Credits also known by the abbreviation UCP 600 (hereinafter, 'UCP 600' or 'UCP') that provides for harmonized rules[18] for processing letters of credit defines it as "*any arrangement, however name or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation*'[19]. In simple words, a letter of credit issued by a bank constitutes a binding obligation to release the payment to the beneficiary when the beneficiary complies with its requisite conditions[20].

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[18] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 21 comments: "Today, nearly all credits throughout the world are issued subject to the Uniform Customs and Practice for Documentary Credits (UCP), and discussion of both law and practice demands reference to the UCP, if it is to be comprehensive. Attempts at global unification of law and practice have generally met with mixed success at best, but documentary credits constitute a notable exception to this observation, an achievement perhaps more remarkable given that these are a private set of rules."; Royal Bank of Scotland v. Cassa di Risparmio dette Provincie Lombarde 1 Bank LR 251 (1992) states: "Undeniably the Uniform Customs and Practice have an important role in the conduct of international trade. They expound technical terms; they promote consistency; and they enable the parties to express their intentions briefly, without the need to negotiate and set out all the terms of the relationship at length. Nevertheless, whilst not belittling the utility of the UCP, it must be recognized that their terms do no constitute a statutory code. As their title makes clear they contain a formulation customs and practices, which the parties to a letter of credit transaction can incorporate into their contracts by reference ….If on the other hand the agreement is silent in the material respect, then recourse must be had to UCP, and if a relevant term is found there, that term will govern the case."

[19] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 389 (UCP provisions do not have any application to the letter of credit unless they are expressly incorporated but usually the banks universally rely upon them imposing them on their customers (the buyer) and the beneficiary (the seller)); UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 2.

[20] Hamzeh Malas v. British Imex 2 QB 127 (1958) where Jenkins LJ notes that "the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay …. A vendor of goods selling against a confirmed letter of credit is selling under assurance that nothing will prevent him from receiving the price."; Guranty Trust Company of New York v. Hannay 2 KB 623 (1918) where the Court states "The vendor, to help the finance of his business, desires to get his purchase price as soon as possible after he has despatched the goods to his purchaser; with this object he draws a bill of exchange for the price, attaches to the draft the documents of carriage and insurance of the goods sold and sometimes an invoice for the price, and discounts the bill – that is, sells the bill, with the documents attached, to an exchange house."; Rufus James Trimble, "The Law Merchant and the Letter of Credit" Harv. L. Rev. 61, no. 6 (1948): 983-984 which states "A business letter requesting a person to pay money, or make his credit available, to a third person, on the credit of the write or against payment by him, is a letter of credit".

What makes a letter of credit a popular means of payment is its ability to address the anxieties and hesitation of the parties to any contract. International Chambers of Commerce in its 2016 Report the state of International Trade and Finance noted that though the use of Letters of Credit is steadily declining, yet, it still remains by far the most used instrument for payment accounting for a total of about 38% of the trade finance product mix[21]. It further found that there has been a steady increase in reliance on standy letters of credit and performance guarantees with their cumulative use being about 25% of the total trade finance product mix[22]. Thus, still substantially, the global trade relies upon these instruments, and more specifically, upon letter of credit to make payments and finance their trade.

A seller is anxious about receipt of payment upon agreeing to undertake a large enterprise or at the very least when he puts the goods en route to the buyer[23] or that the payment will not be reneged on account of change in market. A buyer on the other hand would not prefer to release the payment to the seller until he is assured that the necessary goods have been shipped according to his instructions[24] especially in the cases where the seller is from different country. In an ordinary exchange, the buyer (or the importer) who is making a purchase from the seller (or the exporter) can assure the seller that the payment will be made upon presentation of certain documents[25]. The seller on the other hand is assured that it can

[21] International Chambers of Commerce, "2016: Rethinking Trade & Finance," International Chambers of Commerce, accessed on 1st July 2018. http://store.iccwbo.org/content/uploaded/pdf/ICC_Global_Trade_and_Finance_Survey_2016.pdf. at 36

[22] International Chambers of Commerce, "2016: Rethinking Trade & Finance," International Chambers of Commerce, accessed on 1st July 2018. http://store.iccwbo.org/content/uploaded/pdf/ICC_Global_Trade_and_Finance_Survey_2016.pdf. at 42

[23] William McCurdy, "Commercial Letters of Credit", *Harv. L. Rev.* 35, no. 5 (1922): 540; Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 4.

[24] William McCurdy, "Commercial Letters of Credit", *Harv. L. Rev.* 35, no. 5 (1922): 540

[25] Trans Trust v. Danubian Trading 1 Lloyd's Rep 348 (1952) notes that "[A letter of credit" is irrevocable by the banker; and it is often expressly made transferable by the seller. The seller may be relying on it to get the goods himself. If it is not provided, the seller may be prevented from getting the goods at all"; Paul Todd, *Bills*

access the payment once it completes its contractual obligations and furnishes the necessary documents[26]. In this manner, the bank becomes the intermediary that removes the risk of the parties in the commercial transaction by guaranteeing payment upon fulfillment of the conditions specified in the letter of credit[27].

An ordinary transaction would involve the buyer and the seller agreeing to a contract where the seller undertakes to perform the contract and the buyer agrees to make the payment[28]. The letter of credit enables the buyer to securely deposit the money in the bank which can only be

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of Lading and Bankers Documentary Credits (London: Informa, 2007), 12 notes "In place of a buyer whose financial standing may be unknown, the seller knows that he can look to a reputable bank for payment, "a reliable and solvent paymaster". The bank thus takes over the risk of the buyer's insolvency, and takes upon itself the problem of eventual recovery of the money from the buyer."; Matti Kurkela, *Letters of Credit and Bank Guarantees under International Trade Law*, (New York: Oxford University Press, 2008), 35 calls it a "double" security that "The credit provides the beneficiary a security for honor of his claims for the agreed price provided that he meets the conditions precedent set forth in the credit: he may rest assured that payment will be effected and that the commitment remains firm and irrevocable despite changes at marketplace and in particular beyond the will of the account party and his possible change of mind."

[26] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 388

[27] Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 387; Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 10 notes "The interests of sellers and buyers can only be reconciled by the intervention of a third party, which is usually, but not necessarily, a bank. The bank undertakes its own obligation to pay the seller, that obligation being entirely independent of the buyer's obligation to pay under the sale contract, and irrespective of any real or imagined disputes under that contract. … In a modern irrevocable documentary credit, the bank also takes the risk of the buyer's insolvency, otherwise a major worry for sellers. The intervention of the third party thus resolves many of the worries necessarily experienced by sellers dispatching (and losing control of) expensive cargo bound for foreign parts, before being paid, while at the same time financing the transaction, and resolving buyers' cashflow difficulties."; Arthur Jr. Fama, "Letters of Credit: The Role of Issuer Discretion in Determining Documentary Compliance", Fordham L. Rev. 53, no. 6 (1985): 1521 notes "By substituting a bank's credit for the buyer's credit, the letter of credit theoretically eliminates three major risks otherwise imposed on the seller in the documentary sale. First is the insolvency risk .. Second, the seller faces the dishonesty risk … Finally, there is the honest-dispute risk."

[28] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 85: "The terms of the credit must comply with any express provisions of the sale contract. If it does not, the seller will be bound by its terms, vis-`a-vis the bank, but will be entitled to treat the buyer under the sale contract, as not having put in place a proper documentary credit." Courts would not usually intervene should inconsistency be present as McNair J in Soproma SpA v. Marine & Animal By-Products Corporation that "the credit itself should set out in detail the specific conditions under which it can be operated including the period of its availability and that so long as these conditions are fair and reasonable and not inconsistent with the terms of the contract itself no objection can be taken to them by the seller".

released upon the presentation of documents stipulated in the letter of credit[29]. The seller, thereafter, upon presentation of these documents can receive the payment under the letter of credit[30].

Also, the transaction of letter of credit would ordinarily involve two banks. The issuing bank being the one approached by the buyer which originally issues the letter of credit and the confirming bank (acting as the advising and/or confirming bank) being the bank located at the place where the seller would present the documents[31]. In case of an international transaction,

[29] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 7(a) states "a. Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honour if the credit is available by:

i. sight payment, deferred payment or acceptance with the issuing bank;

ii. sight payment with a nominated bank and that nominated bank does not pay;

iii. deferred payment with a nominated bank and that nominated bank does not incur its deferred payment

undertaking or, having incurred its deferred payment undertaking, does not pay at maturity;

iv. acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or,

having accepted a draft drawn on it, does not pay at maturity;

v. negotiation with a nominated bank and that nominated bank does not negotiate."

[30] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001) 1-09

[31] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 1-17: "The seller will often stipulate that the credit to be issued by the bank be available through and/or confirmed by a particular bank, with which it has previously arranged facilities for negotiation of the credit or an advance of the price"; Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 388 notes "the issuing bank in accordance with the buyer's instructions issues a letter of credit to the beneficiary and for such purpose instructs a correspondent bank (located in the seller's country) to act as an advising bank. In turn, the advising bank informs the seller/beneficiary that a letter of credit is opened in his favour and that payment will be made conditional upon the presentation of the stipulated documents by the seller to the advising bank (or another bank nominated for payment purposes) by a specified date."; UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 2 provides: "Confirming bank means the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.

Issuing bank means the bank that issues a credit at the request of an applicant or on its own behalf.

the issuing bank would be located in the country of the buyer and the confirming bank would be located in the country of the seller[32].

III. CONTRACTUAL RELATIONSHIPS EMBODIED IN LETTER OF CREDIT

Though there is a tussle as to whether the documentary credit is a contract[33] or is a *mercantile speciality*[34]. Yet, such differentia is of little practical consequence in as much the remedies for their breach follow ordinary rules of contract[35].

The relationship between the four parties is construed as five *interconnected* but autonomous contract[36] or atleast, there will be a minimum of three such contracts in case the issuing bank

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Nominated Bank means the bank with which the credit is available or any bank in the case of a credit available with any bank."

[32] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 14: "It is therefore common to stipulate the irrevocable credit should also be confirmed by a bank in the seller's country of business, in which case the confirming bank adds its own, additional and independent undertaking to that of the issuing bank. …. The advantages to the seller are therefore that not only is he protected against the insolvency of the buyer, but also against the prospect of having to settle disputes with a foreign bank in a foreign country, with all the attendant expense and inconvenience."

[33] United City Merchants v. Royal bank of Canada AC 168 (1983); Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 15 citing the House of Lords decision in United City Merchants states that "Since that decision, it has been impossible to argue that documentary credits have other than a contractual basis".; Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 258 further states that: "To base documentary credits other than on contract would have entailed developing a special law for them. Not only would this be difficult to justify in principle, but it could also be far too restrictive."; Rufus James Trimble, "The Law Merchant and the Letter of Credit" Harv. L. Rev. 61, no. 6 (1948): 986 discussing the origins of letter of credit in common law notes that there was initially a difficulty in reception of such instruments on account of common law concept of consideration but however, they were received and came to considered "formal contract …an order or promise to pay money, made according to the custom of merchants and delivered animo solvendi".

[34] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 3; William McCurdy, "Commercial Letters of Credit", *Harv. L. Rev.* 35, no. 5 (1922): 564;

[35] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 3

[36] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 15

acts as a confiriming bank[37]. The four contracts have been enshrined in the famous passage of Lord Diplock J. in *United City Merchants v. Royal Bank of Canada*[38] where he held that:

> ''It is trite law that there are four autonomous though interconnected contractual relationships involved: (1) the underlying contract for the sale of goods, to which the only parties are the buyer and the seller; (2) the contract between the buyer and the issuing bank under which the latter agrees to issue the credit and either itself or through a confirming bank to notify the credit to the seller and to make payments to or to the order of the seller (or to pay, accept or negotiate bills of exchange drawn by the seller) against presentation of stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated documents, if they include a document of title such as a bill of lading, constitute a security available to the issuing bank; (3) if payment is to be made through a confirming bank, the contract between the issuing bank and the confirming bank authorizing and requiring the latter to make such payments and to remit the stipulated documents to the issuing bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank for payments made under the credit; (4) the contract between the confirming bank and the seller under which the confirming bank undertakes to pay to the seller (or to accept or negotiate without recourse to drawer bills of exchange drawn by him) up to the amount of the credit against presentation of the stipulated documents.''

The fifth contract not covered by the above dictum is the one between the seller and the issuing bank where the beneficiary has been found to have the same rights against the issuing bank as it has against the confirming bank.[39] Though, logically one may be tempted to draw a sixth contract as between the confirming bank and the buyer but there is no such privity of contract[40]. The diagram below depicts the five contracts between the parties.

[37] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 16

[38] United City Merchants v. Royal bank of Canada AC 168 (1983)

[39] Bank of Baroda v. Vysya Bank, Lloyd's Rep 87 (1994)

[40] GKN Contractors v. Lloyds Bank 30 BLR 48 (1985)

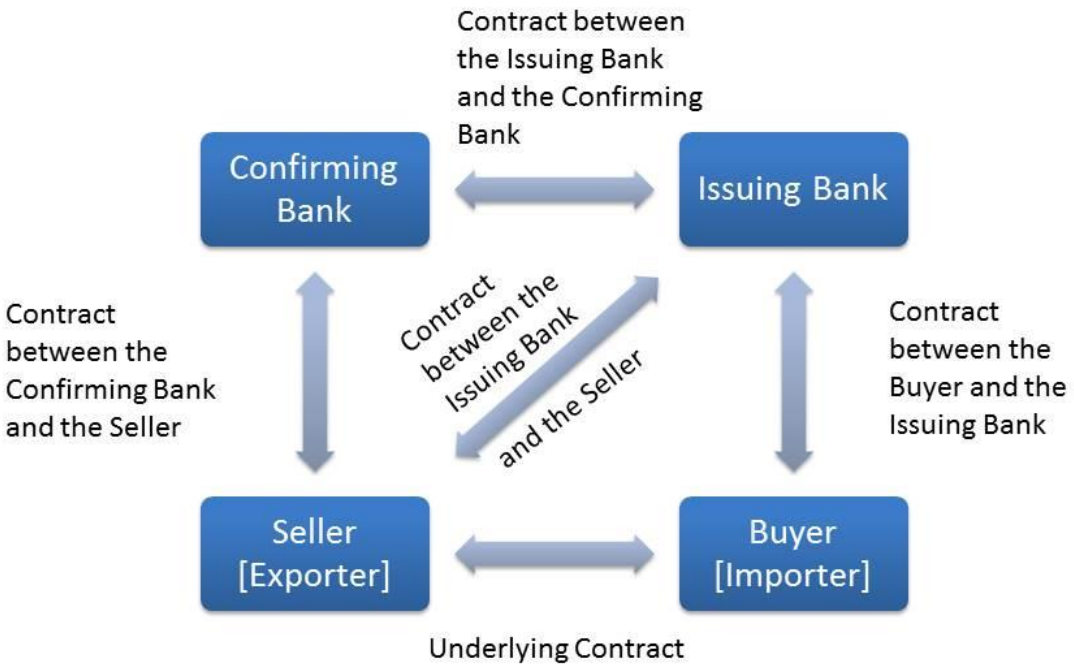

Diagram 1: The five interconnected contracts

The above diagram depicts the four parties and their five interconnected contracts. These five relationships are contractual in nature imposing on parties separate obligations. The underlying contract is the contract of sale between the Seller and the Buyer. This is the contract under which the letter of credit is issued by the buyer as a mode of payment. This contract stipulates the terms of the credit under which the letter of credit is to be issued[41]. The Buyer and the Seller retain their liabilities against each other for any breach of this contract, that is, any claim for non-performance against the Seller will remain available to the Buyer

[41] Transpetrol v. Transol Olieprodukten Nederland BV Lloyd's Rep 309 (1989) where the Court found that the buyer was in violation of the contract for failing to open the letter of credit within stipulated time and therefore, liable for damages; In Trans Trust v. Danubian Trading, 2 QB 297 (1952) the Court found that the Seller had incurred costs on account of the contract of sale and the failure of the Buyer to open the letter of credit constituted a breach of contract.

and similarly, all defenses against such claims would be available to the Seller. Ordinarily, the terms of the letter of credit will be in consonance with the sale contract[42]. But in case the buyer places a contradictory term in the letter of credit, the seller can bring action against the buyer under the sale contract[43] but not against the issuing bank or the confirming bank[44].

The second contract is between the Buyer and the Issuing Bank. Here the Buyer is the customer of the Bank and contracts with the bank to issue a letter of credit where the Bank is bound to pay upon fulfillment of stipulated conditions. These conditions constitute a mandate upon the Bank to strictly observe the conditions prior to release of the payment. But in case the Bank makes a payment against non-complying documents then, the Bank will be liable to indemnify the Buyer[45]. Having said so, the Buyer does not have the right of verification over the compliance of the documents prior to the release of the payment[46]. This is because the letter of credit is an autonomous contract where the Bank does not act as the agent of the buyer.

The Issuing Bank may contract with another bank to fulfill the mandate under the letter of credit. When the other bank acts as an advising bank, then, it has no responsibility to effect

[42] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 235

[43] Glencore Grain Rotterdam v. LORICO, Lloyd's Rep 386 (1997) where the Court found that the Buyer's stipulation of condition in the letter of credit contradictory to the sale contract constituted a breach of the sale contract by the buyer.

[44] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 85

[45] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 240 states that "the test is whether the bank has taken reasonable care to ensure that the documents conform. Only if it has not done so will it be liable to its customer"*;* In Equitable Trust Company of New York v. Dawson Partners 27 Lloyds' Rep 49 (1927) where the Court notes "letters of credit, like other commercial contracts, have tobe carried out in strict accordance with their terms".

[46] Bayerische Vereinsbank v. Bank of Pakistan, Lloyd's Rep 59 (1997) where the Court observed that the bank would fail its responsibility if it were to merely hand over the documents to the applicant for evaluation as to compliance by the Seller.

payment but only to authenticate the credit and forward it to the beneficiary[47]. When the second bank is a confirming bank, then the bank is bound to honor the letter of credit to the beneficiary[48]. In other words, the confirming bank "stands in the same position as the issuer, as the paymaster under the law of letters of credit"[49]. The relationship between the Issuing Bank and the Advising or the Confirming Bank is that of principal and agent[50]. Thus, when the Confirming Bank fully complies with its mandate, it is entitled to reimbursement from the Issuing Bank[51]. The Issuing Bank will be compelled to make payment to the Confirming Bank when the documents are complying[52]. It is clear that neither bank would be concerned with any question or issue arising under the sale contract and would remain confined to assessment of conformity of documents as stipulated under the letter of credit[53].

The fourth contract is between the Seller and the intermediary bank. The obligation of the Seller is make a complying presentation of the documents stipulated in the letter of credit to receive the payment. However, the obligation of the intermediary bank is dependent upon whether it is an advising bank or a confirming bank[54]. A bank acting as an advising bank has

[47] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 9(a) states that "An advising bank that is not a confirming bank advises the credit and any amendment without any undertaking to honour or negotiate."

[48] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 8

[49] Xiang Gao, *The fraud rule in the Law of Letters of Credit: A Comparative Study* (Hague: Kluwer Law International, 2000), 143

[50] Bank of Baroda v. Vysya Bank, Lloyd's Rep 87 (1994)

[51] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 4-66

[52] In Fortis Bank v. Indian Overseas Bank Lloyd's Rep 227 (2010) the Court stated that "Under the UCP the obligation to reimburse the nominated bank arises if it honours or negotiates a complying presentation and forwards the documents to the issuing bank. In the present case Fortis did negotiate what on their case was a complying presentation and did forward the documents to IOB. What matters is the fact of honouring or negotiating a complying presentation."

[53] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 236

[54] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 4-82

no obligation to make any payment to the Seller but only to advise on the documents[55]. The Bank that confirms the credits makes a promise to honour the payment under the letter of credit upon complying presentation[56]. Similar is the position of the Issuing Bank vis-à-vis the Seller which is also bound to honour the payment obligation upon a complying presentation of documents[57].

As the foregoing shows that the obligations accruing from opening of a letter of credit are interconnected, in the sense, fulfillment of one obligation sets in motion a chain of fulfillment of obligations in other contracts. However, each of these contract are yet kept independent and autonomous so as to ensure smooth functioning of the credit system. What the above also depicts is that the unlike current account financing which will be wholly unsatisfactory to the Seller for it opens him to severe risk of reneging payment by the Buyer or an issuance of promissory note by the Buyer which opens him to risk of payment at maturity without any means to him to evaluate the actions of Seller, the letter of credit addresses both these concerns. By making the payment under letter of credit contingent upon presentation of certain documents, the Buyer has protection that the money will not be released till at least facial compliance of necessary documentation is done by the Seller, while the Seller is

[55] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 4-83

[56] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 15: Complying Presentation

> a. When an issuing bank determines that a presentation is complying, it must honour.
>
> b. When a confirming bank determines that a presentation is complying, it must honour or negotiate and forward the documents to the issuing bank.
>
> c. When a nominated bank determines that a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank.

[57] United City Merchants v. Royal Bank of Canada AC 168 (1983) where Lord Diplock stated that "If, on their face, the documents presented to the confirming bank by the seller conform with the requirements of the credit as notified to him by the confirming bank, that bank is under a contractual obligation to the seller to honour the credit, notwithstanding that the bank has knowledge that the seller at the time of presentation of the conforming documents is alleged by the buyer to have, and in fact has already, committed a breach of his contract with the buyer"

assured of presence of money which he would receive upon completion of his sale. Above all, the issuance of letter of credit also enables both the Sellers and Buyers to secure discounting or advances to carry out further activities[58]. This makes the letters of credit a secure means of payment[59].

This is true for bank guarantees and performance bonds. Though, bank guarantees and performance bonds operate differently in terms of payments from letters of credit[60]. Yet, the law on bank guarantees and performance bonds is identical to that of letters of credit in as much that the relationship between the buyer, the seller and the bank are governed not by the contract of sale but the terms for their issuances[61]. Though, a bank guarantee is issued generally in cases where one party is concerned that the other may default on its liabilities, yet, the applicable principles are the same[62]. Both letters of credit and bank guarantees share the essential feature as in they are designed to "indemnify their respective beneficiaries (also known as "account party" or "applicant for the credit or for the bank guarantee)"[63]. The cases

[58] Matti Kurkela, *Letters of Credit and Bank Guarantees under International Trade Law*, (New York: Oxford University Press, 2008), 32-34

[59] William McCurdy, "Commercial Letters of Credit", *Harv. L. Rev.* 35, no. 5 (1922): 542; Gabriel Moens and Peter Gillies, *International Trade and Business: Law, Policy and Ethics*, (Sydney: Cavendish Publishing (Australia) Pty Limited, 2000), 387 notes "Letters of credit are popular instruments in international trade because they substitute the financial standing of a bank for that of an individual or firm.".

[60] Roy Goode and McKendrick, *Goode on Commercial Law*, (London:Penguin Books, 2010), 14-15 states "the documentary credit is designed to ensure the discharge of payment obligation. By contrast, the demand guarantee is used almost exclusively to secure the performance of a non-monetary obligation ..and is conceived as a default mechanism …whereas a banks pays a documentary credit only if things go right, in the case of demand guarantee it is intended that the bank will be called upon to pay only if things go wrong."

[61] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 255: "Performance bonds, like documentary credits, are treated as the equivalent of cash." And "The law on standy credits and performance bonds is similar to that on documentary credits"

[62] Matti Kurkela, *Letters of Credit and Bank Guarantees under International Trade Law*, (New York: Oxford University Press, 2008), 13: "Traditional guarantees, being under the freedom of contract, may well be drafted to resemble letters of credit requiring presentation of specified documents as a condition precedent for a payment obligation or another obligation to arise."

[63] Boris Kozolchyk, "Bank Guarantees and Letters of Credit: Time for a Return to the Fold", *U. Pa. J. Int'l L.* 11 no. 1 (1989): 7

regarding bank guarantee, performance bonds, and other irrevocable bank guarantees also apply the same standard as has been applied in the cases concerning letter of credit[64]. That is, they are subject to the same principles of autonomy and non-interference as would be applicable in cases concerning letters of credit[65].

The key reason behind their positive reception lies in its properties as what has been called as "abstract payment undertakings"[66]. This formulation by Roy Goode aptly captures the characteristic of both documentary credits, including letter of credit as well as demand guarantees.

> "Documentary credits and demand guarantees … are abstract payment undertakings, so that they are not required to conform to the ordinary conditions for a valid and binding contract. Both are autonomous in character, so that in principle the bank's duty is to pay against conforming documents without regard to whether, in the case of documentary credits, there has been proper performance of the underlying contract by the beneficiary or, in the case of demand guarantees, there has been a breach of the underlying contract. Both are documentary in character, so that the obligation is triggered solely by presentation of documents within time and on the terms specified in the undertaking without regard to external facts or events. In both cases the bank fulfills its duty by paying against documents which appear, on reasonable examination, to confirm to the credit."[67]

That is, a documentary credit has certain features that make it stand out within the trading community for its benefits: *first* – it is a binding obligation on the bank to effect the payment upon completion of the stipulated conditions; *second* – it is autonomous of the underlying

[64] For differences between bank guarantee and letters of credit, see Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 15-16

[65] Themehelp v. West QB 84 (1996); Harbottle v National Westminster Bank QB 146 (1978) where Lord Denning stated that "the performance guarantee stands on a similar footing to a letter of credit"; Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 255

[66] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996)

[67] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 4

sale transaction and ensures continuity of trade[68] and *third* – it is concerned with compliance of documentary requirements where the banks assume chief role in their functioning.

IV. THE PRINCIPLE OF STRICT COMPLIANCE

The role of the Banks is strictly defined under UCP which is predicated upon the assumption that the Banks are experts in evaluation of appearance of documents but lacking any expertise in handling goods. The Article 5 of UCP enshrines this position in the succinct statement that "*Banks deal with documents and not with goods, services or performance to which the documents relate*." Also, both the Issuing Bank and the Confirming Bank are under an obligation to honour the credit when the stipulated documents presented constitute compliance under the terms of credit[69]. This is the undertaking given by the Bank when it issues a letter of credit. In the words of Viscount Sumner in *Equitable Trust Company of New York v. Dawson Partners [70]*,

> "It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to accept are in the manner of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well."[71]

What the foregoing means that the compliance of terms of credit would be found only in case the terms of the credit are strictly complied with. This is because the Bank is under mandate by the Buyer and owes a duty to not release the payment when the documents do not conform

[68] Matti Kurkela, *Letters of Credit and Bank Guarantees under International Trade Law*, (New York: Oxford University Press, 2008), 35 notes "Besides providing direct financing by way of deferred payment or negotiation or acceptance of drafts, letters of credit are used as collateral and as back-up for financing."

[69] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Articles 7(a)and 8(a)

[70] Equitable Trust Company of New York v. Dawson Partners 27 Lloyds' Rep 49 (1927) (This case concerned where the buyer had mandated the bank to secure certificates from experts whereas the bank released the payment to the seller on supply of a single certificate. It turned out that rubbish was shipped by the seller rather than the actual goods. The Court accordingly granted injunction against the bank from debiting the account of the buyer.)

[71] Equitable Trust Company of New York v. Dawson Partners 27 Lloyds' Rep 49 (1927)

to the terms of the credit[72]. This mandate is detailed in the terms of the credit requiring the Bank to ensure that the documents when presented meet all the requirements that are provided by the Buyer. Furthermore, the bank's own reputation and the trust it inspires among the clientele is predicated upon it carrying out its instructions strictly[73]. So, when processing the letter of credit, the bank is concerned solely with the terms stipulated in the letter of credit and then to evaluate the documents that are tendered. And the standard of compliance is strict.

This principle found its affirmation in rather harsh case of *Edward Owen v. Barclays Bank*[74]where the performance bond was payable "*on demand without proof and conditions*". The Seller who had issued the performance bond sought to restrain the payment under it on the ground that the Buyer was in breach of its agreement having failed timely to open the letter of credit. But the Court rejected the submission and succinctly put the principle as:

> "A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions"[75].

[72] English, Scottish and Australian Bank v. Bank of South Africa 12 Lloyd's Rep 21 (1922) where Bailhache J. stated that "It is elementary to say that a person who ships in reliance on a letter of credit must do so in exact compliance with its terms. It is elementary to say that a bank is not bound or indeed entitled to honor drafts presented to it under a letter of credit unless those drafts with the accompanying documents are in strict accord with the credit as opened."

[73] In Harbottle v National Westminster Bank QB 146 (1978) the Court said that "the bank had given its own guarantee, and in effect pledged its own credit, to the Egyptian banks to pay on demand, its reputation depends on strict compliance with its obligations. This has always been an essential feature of banking practice."

[74] Edward Owen v. Barclays Bank 1 QB 159 (1978)

[75] Edward Owen v. Barclays Bank 1 QB 159 (1978)

Thus, the principle of strict compliance requires that the Banks comply only with the terms of the credit "on their face", that is, the documents must have facial or apparent conformity[76]. The logic behind facial conformity is that the Banks have no expertise in goods or the underlying transaction and hence, are capable of determining only on the basis of the documents. To put it differently, the Banks would be placed in serious burden if it were encumbered with a duty to look beyond the documents and examine the underlying transaction and its details for which it may neither have the expertise or the resources[77].

This absence of expertise in trade customs was adjudicated in *JH Rayner v. Hambros Bank*[78], where the Court refused to order the Bank to pay on an action brought by the Seller on the grounds that the documents tendered did not confirm to the terms of credit. The terms of credit required presentation of documents pertaining to "Coromandel groundnuts". The Seller accordingly presented a commercial invoice mentioning "corormandel groundnuts" and bill of lading stating "machine shelled groundnut kernels". The Bank found that the documents did not conform to the requirement of terms of credit and refused to release the payment. The Seller on the other hand contended that it is common knowledge that the coromandel groundnuts are machine shelled groundnut kernels and thus, the documents ought to be considered complying. However, the Court rejected the argument. The Court reasoned that it would be not possible for the bankers to know all the particular details of the way in which

[76] In Banque de l'Indochine et de Suez v. Rayner Lloyd's Rep 476 (1982) the Court stated that "I have no doubt that so long as the documents can be plainly seen to be linked with each other, are not inconsistent with each other or with the terms of credit, do not call for inquiry and between the state all that is required in the credit, the beneficiary is entitled to be paid."; Also UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 14(a) that states "A nominated bank acting on its nomination, or confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation."

[77] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 236-237

[78] JH Rayner v. Hambros Bank KB 37 (1943)

traders carry on their business. Rather the Court categorically rejected such a submission and stated that

> "The bank is not concerned with that. The bank, if it accepts the mandate to open the credit, must do exactly what its customer requires it to do, and if the customer says: "I require a bill of lading for Coromandel groundnuts," the bank is not justified, in my judgment, in paying against a bill of lading for anything except Coromandel groundnuts, and it is no answer to say: "You know perfectly well machine shelled groundnut kernels are the same as Coromandel groundnuts"."[79]

Therefore, the bank's only duty is to assess the facial compliance of the documents presented and to evaluate them as per the terms of the credit. However, if the defect is trivial as in concerning a wrong telex number[80] or a typographical error[81], then the Banks would be justified in ignoring such errors. UCP also makes the provision in Article 14(j) that the address and contact details like "telefax, telephone, email and the like" will be disregarded. This is beneficial because a buyer attempting to reject would not be able to rely on such discrepancies to call for halting of the payment[82].

Another reason behind adopting strict compliance is a practical one. The Banks are required under UCP to communicate its objections to the Seller within five days[83] and thus, are required to make quick decision. The benefit for the Seller is that if the documents are rejected, then, he would learn this as early as possible to take alternate measures[84]. In simple

[79] JH Rayner v. Hambros Bank KB 37 (1943)

[80] Banker's Trust v. State Bank of India Lloyd's rep 587 (1991)

[81] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 6

[82] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 247

[83] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 14(b)

[84] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 238

words, the law imposes the duty upon the Bank to evaluate the documents "on their face", that is, to assess the description and not look into its quality, correctness and validity[85].

But with respect to commercial invoices, UCP categorically requires that the "*description of the goods, services or performance in a commercial invoice must correspond with that appearing in the credit*"[86]. This is considered a strict requirement from which deviation is not permitted. Furthermore, the duty on the banks is to assess whether the documents tendered are consistent with one another, that is, documents that appear inconsistent will be considered non-compliant[87]. This notion should be understood as meaning that the documents that are tendered must relate to the same transaction and that they should not contradict each other[88].

The purpose of this principle is to ensure that the trust in the banking institutions as a whole is maintained. The Buyer is assured that his instructions would be carried out before the payment is released[89] and the Seller is assured that the payment would be received upon presentation of compliant documents irrespective of any disagreement with the buyer[90].

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[85] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 7-12; Gian Singh v Banque de l'Indochine WLR 1234 (1974) the Court stated that "In business transactions financed by documentary credits, banks must be able to act promptly on presentation of the documents. In the ordinary case visual inspection of the actual documents presented is all that is called for. The bank is under no duty to take any further steps to investigate the genuineness of a signature which, on the face of it, purports to be the signature of the person named or described in the letter of credit."

[86] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 18(c)

[87] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 14(d): "Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with data in that document, any other stipulated document or the credit"

[88] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 7-17

[89] Gao Xiang and Ross P. Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", San Diego Int'l L.J. 4 (2003): 124 "by virtue of this principle [strict compliance], the applicant is guaranteed it will not have to pay or reimburse the issuer (if the bank has paid) except against the documents it has specified as triggering the obligation."

[90] Richard King, *Gutteridge and Megrah's Law of Banker's Commercial Credits*, (London and New York: Europa Publications, 2001), 7-01

In sum, it can be concluded that the documents must comply with the specific requirements of the terms of credit. This compliance is strict and it is not open to parties to dispute them after they are opened. It is not open to the banks to consider additional requirements or to waive any specific condition[91]. These documents are required to conform facially, that is, solely on visual inspection. The banks cannot nor are they are required to have knowledge of trade customs or expected to conduct background investigations into the underlying contract[92].

V. THE PRINCIPLE OF AUTONOMY (INDEPENDENCE)

As the foregoing reveals that the letter of credit is seen as a distinct contract from the underlying contract constituting an obligation upon the Bank to pay after the Seller fulfills its obligation to present complying documents. Further, the Bank is under duty to ensure that the evaluation of compliance of documents strictly as per the terms of credit without being affected by any claims or defences in the underlying contract[93]. Together, they ensure that the letter of credit remains an autonomous and independent of the other transactions. This is termed as principle of autonomy or independence of the letter of credit. UCP aptly captures this principle in its Article 4 where it states that:

[91] Gao Xiang and Ross P. Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", San Diego Int'l L.J. 4 (2003): 123

[92] Gao Xiang and Ross P. Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", San Diego Int'l L.J. 4 (2003): 124 "this principle also protects the bank involved, as it spares the bank from value judgments about discrepancies in documents presented and stops the bank from opening the door to scrutinize the underlying transaction, which is not within the scope of its normal business."

[93] Gao Xiang and Ross P. Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", San Diego Int'l L.J. 4 (2003): 119; Howe Richardson Scale v. Polimex-Cekop and National Westminister Bank Lloyd's Rep 161 (1978): "Whether the obligation arises under a letter of credit or under a guarantee, the obligation of the bank is to perform that which it is required to perform by that particular contract, and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or by the buyer to the seller as the case may be under the sale and purchase contract; the bank here is simply concerned to see whether the event has happened upon which its obligation to pay has arisen."

> "A credit by its nature is a separate transaction from the sale or the other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary.
>
> A beneficiary can in no case avail itself of the contractual relationship existing between banks or between the applicant and the issuing bank."[94]

The above principle has become fundamental to law of letters of credit being widely recognized and applied by courts around the world[95]. The position is illustrated in the words of Hirst J.,

> "It is of course very clearly established by the authorities that a letter of credit is autonomous. That the bank is not concerned in any way with the merits of the underlying transaction, and only in the most extremely exceptional circumstances should the Court interfere with the payment bank honouring a letter of credit in accordance with its terms bearing in mind the importance of the free and unrestricted flow of normal commercial dealings."[96]

A case in point is that of *Urquhart Lindsay v. Eastern Bank*[97] where the defendant bank specifically took the objection that the underlying contract of sale that provided for payment in terms of proforma invoice ought to be considered and therefore, the bank cannot pay as per the invoices presented. However, the Court explicitly rejected such a submission stating that the terms of credit required the bank to confine itself to the invoices presented as so was required under the terms of the credit and concluded with the pithy statement:

[94] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 4(a)

[95] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 12

[96] Tukan Timber v. Barclays Bank Lloyd's Rep 171 (1987)

[97] Urquhart Lindsay v. Eastern Bank KB 318 (1922)

> "It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit."[98]

Also, the principle of autonomy embodies the principle of privity of contract where the third party has no right to interfere in the fulfillment of the contractual obligations *interse* the Seller and the Bank[99]. This is beneficial for the bank because the bank neither has knowledge nor a reason to look into the underlying transaction or its non-performance by the parties[100].

To conclude, the only concern of the bank is to assess whether the documents tendered by the beneficiary conform visually with the terms of the credit. The bank is no way concerned with the underlying transaction as to whether it has successfully been completed or that the disputes have arisen or that the applicant itself has gone bankrupt[101]. The principle of autonomy ensures that the relationships between the buyer, seller and the bank remain separate and independent of the other and that the bank remains confined to assessment of the form of documents presented to it[102]. In this way, the bank becomes the reliable intermediary whose reputation becomes the basis that the payment would honored after the complying documents are presented[103]. The upshot of this principle is that it ensures that the Seller cannot encash the payment without furnishing all the relevant documentation and the Buyer cannot renege on the payment once such documentation is furnished[104]. The continued

[98] Urquhart Lindsay v. Eastern Bank KB 318 (1922)

[99] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 17

[100] Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 17

[101] Gao Xiang and Ross P. Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", San Diego Int'l L.J. 4 (2003): 121

[102] Lord Goff in Westpac Banking Corporation v. South Carolina National Bank Lloyd's Rep 311 (1986) states that: "it is well settled that a bank which issues a letter of credit is concerned with the form of the documents presented to it, and not with the underlying facts. It forms no part of the bank's function, when considering whether to pay against the documents presented to it, to speculate about the underlying facts."

[103] Bolivinter Oil v. Chase Manhattan Bank WLR 392 (1984)

[104] Power Curber International v National Bank of Kuwait WLR 1233 (1981) "It is vital that every bank which issues a letter of credit should honour its obligations. The bank is in no way concerned with any dispute that the

reliance upon the letter of credit as method of payment is predicated upon the reputation of the bank that it would honor its obligations after the complying conditions are met. If such letters of credit are easily interfered with, it would seriously undermine the trust in the banks damaging its reputation and in turn, affecting the banking system as a whole[105].

However, every jurisdiction admits of few exceptions to this rule in order to ensure that the honesty in the commerce is maintained[106]. Just as the reputation of the bank is based upon in ensuring that the promise of the payment will be kept when complying documents are presented, then, in the same way, the trust in the banking system is maintained when it remains insulated from fraudulent and such activities that may undermine that trust. The purpose of this thesis is to evaluate these exceptions where the Banks can be compelled to refuse payment after complying documents are presented by the Seller in England and India. The analysis would be made on assessing the doctrinal principles evolved by the Courts in these two jurisdictions to decide when such interference is justified.

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buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless the bank must honour its obligations. The buyer may say that he has a cross-claim in a large amount. Still the bank must honour its obligations. A letter of credit is like a bill of exchange given for the price of goods. It ranks as cash and must be honoured."

[105] Bolivinter Oil v. Chase Manhattan Bank WLR 392 (1984) where the Court stated that: "for irreparable damage can be done to the bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged."; Hamzeh Malas v. British Imex 2 QB 127 (1958) where the Court stated it succinctly that: "the opening of a confirmed letter of credit constitutes a bargain between the banker and vendor of the goods, which impose upon the bank an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice. "; Harbottle v National Westminster Bank QB 146 (1978) "The bank had widespread connections with banks in the Middle East, and indeed all over the world. Its reputation is part of its stock-in-trade and depends upon prompt and scrupulous fulfilment of its obligation."; United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985) "While accepting that letters of credit and performance bonds are part of the essential machinery of international commerce (and to delay payment under such documents strikes not only at the proper working of international commerce but also at the reputation and standing of the international banking community), the strength of this proposition can be over-emphasised."

[106] Roy Goode, "Abstract Payment Undertakings in International Transactions", *Brook. J. Int'l L.* 22, no. 1 (1996): 13

INJUNCTION AGAINST LETTER OF CREDIT UNDER ENGLISH LAW

With the examination of the principles governing letter of credit covered in the previous chapter, the subsequent chapters will examine the operation of injunction against the payment obligations under letter of credit or bank guarantees. Though, the instruments are considered separate and distinct from the underlying transaction and it is considered foregone that the payment would occur after the complying presentation is made, yet, almost all the cases where these principles were discussed by the Courts emanated from the prayer of a concerned party to restrain such payment. This chapter discusses the various grounds under which such interference is permitted by the English Courts.

Traditionally, English Courts have remained very conservative when it comes to halting the payment obligations under letters of credit[107]. Though, as the cases discussed below would admit of variety of situations under which these obligations can be interfered with, yet, the Courts have been very reluctant in issuance of injunctive reliefs[108]. This can be gleaned from the view taken by the Courts where they have equated that seeking restraint against the bank from paying out is identical to seeking restraint from the beneficiary from taking the deposit[109].

I. THE FRAUD RULE: *EX TURPI CAUSA NON ORITUR ACTIO*

The first principle to be considered is the Fraud rule. Under this rule, the bank will be absolved of its obligation to make the payment when the beneficiary commits fraud. This is

[107] Agasha Mugasha, *The Law of Letters of Credit and Bank Guarantees* (Sydney: Federation Press, 2003) 148; Gao Xiang and Ross Buckley, "A Comparative Analysis of the Standard of Fraud Required Under the Fraud Rule in Letter of Credit Law", *Duke Journal of Comparative & International Law* 13, no. 2 (2003): 322

[108] Deborah Horowitz, *Letters of Credit and Demand Guarantees: Defences to Payment* (Oxford: Oxford University Press, 2010), 27

[109] Group Josi v. Walbrook Insurance Lloyd's Rep 345 (1996)

the first exception to be considered. However, a reliable definition of what constitutes fraud has remained elusive as it is seen as a pliable concept[110]. The inherent problem being that there is no consensus on a definition that would satisfy every situation[111]. The cases would therefore reveal the scope of the fraud rule as it has been developed and applied by the Courts.

I.1. FRAUD IN THE DOCUMENTS OR FRAUD IN THE UNDERLYING TRANSACTION

To address the question of what constitutes fraud, it is essential to examine as to what evidence would be considered by the Courts while making such a determination. That is when confronted with prayer for injunction, would Court confine themselves to the documents presented as part of the compliance with the terms of credit or would they expand their inquiry to consider whether the beneficiary has committed fraud in the underlying transaction itself. Though, the majority of cases seeking restraint on the ground of fraud would involve fraud in documents[112] but there have been views suggesting that fraud in the underlying transaction itself could lead to restraint of payments[113].

One of the first cases that came before the English Courts alleging absence of correspondence between the goods shipped and the documents tendered to the bank by the seller was that of

[110] Gerald McLaughlin, "Letters of Credit and Illegal Contracts: The Limits of the Independence principle" *Ohio St. L.J.* 49, no. 5 (1989): 1203

[111] Sir James Fitzjames Stephen, *A History of the Criminal Law of England Volume III* (London: Macmillan & Co, 1883), 121 where he states that "There has always been a great reluctance amongst lawyers to attempt to define fraud, and this is not unnatural when we consider the number of different kinds of conduct to which the word is applied in connection with different branches of law, and especially in connection with the equitable branch of it."

[112] Deborah Horowitz, *Letters of Credit and Demand Guarantees: Defences to Payment* (Oxford: Oxford University Press, 2010), 30 states that "In the vast majority of letter of credit cases, the fraud *will* constitute fraud in documents.";

[113] John Dolan, "Tethering the Fraud Inquiry in Letter of Credit Law", *Banking and Finance Law Review* 21 (2006): 489 states that: "As a general rule, commercial law commands courts to look to the underlying transaction as part of the fraud inquiry."; Agasha Mugasha, *The Law of Letters of Credit and Bank Guarantees* (Sydney: Federation Press, 2003) 145-6 states that "Overall, the weight of opinion favours the liberal construction which permits the court to enjoin payment if there is fraud either in the documents or in the underlying transaction."

of *Discount Records v. Barclays Bank International*[114]. In this case, the plaintiff brought a suit for injunction against the bank which was arrayed as the defendant. However, the Court declined to restrain the defendant banks reasoning that the case was one where the fraud was alleged but had not been established[115] in view of the fact that the seller was not party to the suit and the inability of the bank to contest the evidence. Though, the Court declined[116] to grant the prayer for injunction against the banks, yet, the judgment did not deny the application of fraud rule to payment obligations under a letter of credit.

The Court in the case of *Harbottle v. National Westminister Bank Ltd*[117] was called upon to adjudicate upon restrain of payment of bank guarantee on account of fraud perpetrated by the buyer. The nature of the bank guarantee was that of 'first demand' without any safeguard. The Court after expressing surprise at the unconditional nature of the guarantee concluded that the guarantee would have to be released as there was no particular stipulation to its release. The Court rejected the case of fraud and the submission that the plaintiff would be in difficulty in pursuing the claim against the beneficiary on the reasoning that:

[114] Discount Records v. Barclays Bank International Lloyd's Rep 444 (1975) (The plaintiff in this case was the buyer and the defendants were the banks involved in the transaction. The plaintiff's case was that the seller, who was the beneficiary under the letter of credit, had failed to provide the goods as per the stipulations in the terms of credit and therefore, the presentation of documents before the banks was fraudulent on account of the goods actually supplied being at variance with what was stated in the document.)

[115] Discount Records v. Barclays Bank International Lloyd's Rep 444 (1975) "During the argument on this point before me, the familiar English phrase 'Fraud unravels all' was also discussed. … In the present case there is, of course, no established fraud, but merely an allegation of fraud. The defendants, who were not concerned with that matter, have understandably adduced no evidence on the issue of fraud. Indeed, it seems unlikely that any action to which Promodisc was not a party would contain the evidence required to resolve this issue. Accordingly, the matter has to be dealt with on the footing that this is a case in which fraud is alleged but has not been established."

[116] Discount Records v. Barclays Bank International Lloyd's Rep 444 (1975) "I would be slow to interfere with bankers' irrevocable credits, and not least in the sphere of international banking, unless a sufficiently grave cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credits."

[117] Harbottle v National Westminster Bank QB 146 (1978) (The plaintiff seller had opened unconditional bank guarantees in favor of a buyer located in Egypt who in turn agreed to open letters of credit in favor of the plaintiff. However, the buyer subsequently failed to open the letters of credit but yet, demanded the payment under the bank guarantees. The plaintiff brought the writ against the defendant banks praying to the Court to restrain the banks from making payment to the buyer as well as to restrain them from subsequently debiting its account.)

> "The courts are not concerned with [plaintiff's] difficulties to enforce such claims; these are risks which the merchants take. ….
>
> The banks are only concerned to ensure that the terms of their mandate and confirmations are complied with, eg of the conformity of the documents presented, and in this case of the fact that a demand for payment had been made by the buyers under their existing guarantee. This is unfortunate for the plaintiffs, but it is what they have agreed. Banks are not concerned with the rights or wrongs of the underlying disputes but only with the performance of the obligations which they themselves have confirmed."[118]

Thusly, it can be seen that the principle of autonomy insulates the claim against the banks on the grounds of non-performance or fraud in the underlying transaction. The Court in both the cases refused to interfere with the payment obligations on account of allegations of fraud in the underlying transaction.

In the case of *Edward Owen v. Barclays Bank*[119], the plaintiff sought restraint of payment under unconditional payment guarantees issued by the plaintiff through the defendant bank in favor of the defendant-buyer. The plaintiff asserted that the payment guarantee was made pursuant to a contract of sale under which the defendant-buyer had agreed to issue irrevocable letters of credit. Since, the irrevocable letters of credit were never opened by the defendant-buyer, it constituted repudiation of contract of sale and consequently, the demand on payment guarantee is fraudulent. However, the Court rejected the submission of the plaintiff asserting that with respect to guarantees stand on same basis in law as letter of credit. Thus, it reasoned that the banks are only concerned with the documents and if there is no fraud in the documents, then, they are obligated to pay. The Court stated that:

> "All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the

[118] Harbottle v National Westminster Bank QB 146 (1978)

[119] Edward Owen v. Barclays Bank 1 QB 159 (1978)

> customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions.
>
> ….
>
> it is well-established that in the case of a confirmed irrevocable credit in respect of a contract for the sale of goods the confirming bank is not in any way concerned with disputes between the buyers and the sellers under the contract of sale which underlies the credit. But I agree also that it is established that there is at any rate one exception to this rule. … That exception is that where the documents under the credit are presented by the beneficiary himself and the bank knows when the documents are presented that they are forged or fraudulent, the bank is entitled to refuse payment."[120]

The above case laid down the proposition that for fraud exception to payment obligation under letter of credit to lie, the plaintiff must clearly demonstrate that the fraud lay in the documents that are presented and not raise disputes as to the underlying transaction.

In the case of *Kvaerner John Brown v. Midland Bank*[121], the Court was confronted with the situation where the beneficiary of the standby letter of credit had made an untrue statement to the bank. Here the term of the credit required the beneficiary to give notice "*in accordance with the Article 8.3 of the [contract]*"[122]. The beneficiary accordingly applied for encashment

[120] Edward Owen v. Barclays Bank 1 QB 159 (1978)

[121] Kvaerner John Brown v. Midland Bank CLC 446 (1998) (The plaintiff who was the seller had opened a standby letter of credit in favor of the buyer who was to be the beneficiary and was arrayed as the second defendant in the suit. Among the terms of standby letter of credit, the beneficiary was required to give a notice to the plaintiff as stipulated under the underlying contract prior to receiving the payment under the standby letter of credit. In the facts of the case, the beneficiary went on to seek payment under the standby letter of credit from the bank and certified that the notice requirement was met. When in fact no such written notice had been forwarded to the plaintiff and the same was communicated by the plaintiff to the bank.)

[122] Kvaerner John Brown v. Midland Bank CLC 446 (1998) "Funds under this Irrevocable Standby Letter of Credit are available to you from time to time in the event that [KJB] is in default under the [contract] against your valid sight draft(s) drawn on [Midland Bank] entioning thereon Credit No.08L/586180 accompanied by [Polyprima's] signed written statement certifying that:

> (a) [KJB] has failed to comply with its obligations under [the contract] specifying the article(s) and paragraph(s) in default; and
>
> (b) that [Polyprima has] given [KJB] the notice required in accordance with Article 8.3 of [the contract]."

of the standby letter of credit certifying that such notice had been given when in fact, it had given no such notice. The Court was asked to restrain the payment under the standby letter of credit on the basis that the demand by the beneficiary was fraudulent. The Court granted the injunction and reasoned that:

> "In the wholly exceptional case where a demand under a performance bond or Standby Credit purports to certify that a written notice has been given as required by the underlying agreement; when it plainly has not been given, the court will, in the exercise of its discretion, grant an injunction to restrain the beneficiary from maintaining the demand accompanied by what is in fact a false certificate. To grant an injunction in such a case is not inconsistent with the general principles set out above."[123]

Therefore, in this case, the Court granted an injunction restraining the bank from making the payment. The reasoning of the Court was clear that the terms of credit itself required a condition in the contract to be fulfilled. And when plaintiff established before the Court that such term, in this case a prior notice, was not made, then the Court found that the subsequent act of the beneficiary to approach the bank stating that such notice had been given constituted fraud.

Though, it can be argued that the Court in this case looked into the underlying transaction in order to assess fraud by the beneficiary. However, it is submitted that that is not plainly the case. The Court remained confined to the terms of credit when assessing whether the presentation was compliant. The Court found that the terms of credit itself required a particular stipulation in the underlying contract to be met, which in the case, was not met and moreover, the beneficiary had made a patently false statement to the bank, then, the case was

[123] Kvaerner John Brown v. Midland Bank CLC 446 (1998)

sufficiently fit to grant an injunction. That is, in this case, the requirements in the underlying contract were *tied in*[124] to the terms of credit and thus, enabling the Court to evaluate them.

This distinction between fraud in the documents and the fraud in the underlying transaction came up recently before the Privy Council in an appeal from the Mauritian Courts in the case of *Alternative Power Solution v. Central Electricity Board*[125] where the respondent was the applicant of the letter of credit and had originally before the Mauritian Courts filed the suit seeking restraint on payment against the appellant. The case of the respondent-applicant rested on the fact that the inspection certificate was not furnished by the respondent-beneficiary at the time of presentation of documents as was required in the underlying contract. However, the terms of credit made no mention of such a requirement. The Court after considering the evidence found that:

> "There is no suggestion that any of the documents presented to Standard Bank were forgeries or that any of them contained, to the knowledge of APS, any material misrepresentation. Nor is it suggested that, in presenting the documents, APS made any implied misrepresentation, whether innocently, or knowingly and dishonestly.
>
> ….
>
> For present purposes the difficulty with those allegations is that they are allegations of breach of contract and thus matters for arbitration and irrelevant to the liability of Standard Bank under the letter of credit. In so far as the judge [Mauritian Courts] relied upon them he erred in principle."[126]

[124] John Dolan, "Standby Letters of Credit and Fraud (Is the Standby Only Another Invention of the Goldsmiths in Lombard Street)" *Cardozo L. Rev.* 7 (1985): 21-22 "the credit will call for the beneficiary's certificate reciting that the account party is in default on the underlying contract or has failed to pay invoices that are due. In these cases it is easy to make the argument that fraud in the underlying transaction becomes fraud in the credit transaction. If the beneficiary defrauded the account party in the underlying transaction, arguably, the account party is not "in default," or the invoices are not "due." ….. A better rule would fashion distinctions based on the nature of the fraud claim. If the alleged fraud or falsity in the document relates to a fact that can be ascertained without resolving underlying contract disputes, courts are well advised to consider the account party's claim."

[125] Alternative Power Solution v. Central Electricity Board UKPC 31 (2014)

[126] Alternative Power Solution v. Central Electricity Board UKPC 31 (2014)

The Court finally concluded that none of the evidence, irrespective of standard of proof, constituted fraud for the purpose of restraining payment under the letter of credit. Thus, the Court found that only the terms of credit are relevant for assessment under letter of credit irrespective of what requirements were stipulated in the underlying contract.

Thus, the principle of autonomy insulates the transactions of letters of credit from the underlying dispute. Put another way, the bank is not concerned with any disputes between the parties under the contract of sale which underlies the terms of credit[127] but only with the documents that are to be tendered. The Court sole concern, in this way, becomes that of evaluating the nature of the document presented for compliance. If the complying document, as in the *Kvaerner*[128] case revealed, is itself untrue, then, the restraining orders would be granted otherwise, the Courts would not intervene.

I.2. KNOWLEDGE OF THE BANKS

Another important aspect prior to grant of restraining orders is that whether the bank itself had knowledge that the beneficiary has presented fraudulent documents. This was the primary concern in the case of *Gian Singh v. Banque de l'Indochine*[129], where the plaintiff was the buyer and prayed that the defendant banks be restrained from debiting its account on account of fraud perpetrated by the seller in the underlying transaction. The defendant bank specifically averred that the duty of the bank was confined to visual inspection of the actual

[127] Edward Owen v. Barclays Bank 1 QB 159 (1978)

[128] Kvaerner John Brown v. Midland Bank CLC 446 (1998)

[129] Gian Singh v Banque de l'Indochine WLR 1234 (1974) (The case involved opening of a letter of credit for purchase of fishing vessel to be built in Taiwan. Among the conditions of compliance, one was that the seller would secure certificate from one Balwant Singh. However, the plaintiff succeeded in establishing that the certificate so presented by the seller to the defendant banks was a forgery and therefore, the defendant bank be restrained from debiting the plaintiff's account. The defendant bank had already made the payments upon presentation of documents and in turn contended that their only obligation was to assess the documents so presented to them.)

documents and that they do not have the duty to further assess their inherent validity[130]. The Court accepting the argument of the defendant bank reformulated the inquiry as to "*whether the certificate, on the face of it, conformed with the requirements of the documentary credit*"[131]. The Court accepted the argument of the banks and found that no restraint against the banks could be made since on the date of presentation of claim the banks were unaware of the fraud in the documents.

This position was reaffirmed in the case of *United Trading v. Allied Arab Bank*[132], where the question of knowledge of fraud on part of banks was raised. Here the Court clarified that the knowledge of fraud must exist prior to making of the payment for the bank to be liable to the applicant. In its absence, the bank would not be liable. The Court reasoned that:

> "It seems to us clear that, where payment has in fact been made, the bank's knowledge that the demand made by the beneficiary on the performance bond was fraudulent must exist prior to the actual payment to the beneficiary and that its knowledge at that date must be proved. Accordingly, if all a plaintiff can establish is such knowledge after payment, then he has failed to establish his cause of action. The bank would not have been in breach of any duty in making the payment without the requisite knowledge. We doubt that this is really open to contest."[133]

[130] Gian Singh v Banque de l'Indochine WLR 1234 (1974) "In business transactions financed by documentary credits Banks must be able to act promptly on presentation of the documents. In ordinary case visual inspection of the actual documents presented is all that is called for. The bank is under no duty to take any further steps to investigate the genuineness of a signature which, on the face of it, purports to be the signature of the person named or described in the letter of credit."

[131] Gian Singh v Banque de l'Indochine WLR 1234 (1974)

[132] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985) (In this case, the plaintiff had issued unconditional guarantees to the buyer, who was arrayed as defendants, through the defendant banks. When the defendant buyer sought to encash the payment, the plaintiff brought the suit seeking restraining orders where they alleged that the buyer had committed fraud in the transaction and therefore, the payment ought not to be made. One of the questions that arose was whether the banks would be liable to the plaintiff if it discharged knowing that the request was fraudulent.)

[133] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

The Court's reasoning is in line with the *Gian Singh*[134] judgment where the Court had ordered the debiting of the applicant's account even when the fraud was established but the bank did not have the notice of fraud at the time of payment. Similarly, in this case, the Court held that the same position holds true. That the bank must have knowledge of fraud at the time of payment, otherwise, the bank would not be liable.

The need for prior knowledge of bank in case of allegation of fraud has been emphasized in multiple judgments of the Court. So, in the case of *Balfour Beatty Civil Engineering v. Technical & General Guarantee*[135], the surety refusing the payment of the bond asserted the fraud exception to argue that it cannot be made liable to pay as it had knowledge of fraud. The Court upon weighing evidence found that the fraud exception was not established but also laid down the remedies for the intermediary with respect to when it comes to be aware of fraud. The Court succinctly put it as:

> "It places on the surety or the bank who refuses to meet a demand the onus of showing that it had clear evidence of fraud at the date of the demand so as to allow it not to pay if the beneficiary is not prima facie to be entitled to judgment. If it fails in that task, it still has the opportunity where again the onus is on it, to establish that it now has clear evidence of the fraud which will again lead to the beneficiary being refused judgment…. If it fails to show even a powerful case judgment will be entered but that does not preclude the surety continuing with a claim to return of the money based on an allegation of fraud if it can persuade counsel that the evidence is such that it is proper to plead it."[136]

Thus, the Court recognized the centrality of knowledge with respect to payment obligations of the bank as well as its right to refuse or seek corrective remedies. It laid down the

[134] Gian Singh v Banque de l'Indochine WLR 1234 (1974)

[135] Balfour Beatty Civil Engineering v. Technical and General Guarantee 68 Con LR 180 (1990) (The plaintiff brought a case against the surety who had issued bonds in favor of third party promising to discharge payment in case of default by the third party. The plaintiff alleged that there was default and that the surety must discharge the payment. In turn the defendant responded by arguing that it would be under no obligation to pay as the plaintiff had committed fraud.)

[136] Balfour Beatty Civil Engineering v. Technical and General Guarantee 68 Con LR 180 (1990)

procedure that for the bank to refuse payment on ground of fraud it must have a clear knowledge of fraud. It further clarified that if during the course of proceedings, the bank can establish fraud then, the bank will not be required to make the payment. Lastly, even if the bank fails to establish fraud and is required to pay, then, it is still entitled in law to recover the payments at a later stage when it can establish fraud by beneficiary. As can be seen, the above reasoning fits neatly with the principle of strict compliance. That is, the bank is confined to mere assessment of documents. But it will not be left without remedy should the knowledge of fraud becomes known to bank. It has the remedy of denying payment as well as recovery in case the payment has been made.

In a different case, the knowledge of fraud on part of the plaintiff was alleged by the defendant. The facts of *Turkiye Is Bankasi v. Bank of China*[137] involved the buyer's bank, the plaintiff in the case, who had issued performance guarantees in favor of buyer on the strength of counter-guarantees issued by the seller's bank, the defendant. In this case, the plaintiff was informed by the seller as well as the defendant that the performance bond be not paid as there is fraud by the buyer on account of series of disputes between the seller and the buyer. However, the plaintiff made the payments under the payment bonds after the representation was made by the buyer and requested the defendant to discharge the counter-guarantees in its favor. However, the defendant refused to do so arguing that the plaintiff was well aware of the fraud prior to release of the payment and hence, the defendant had no obligation to pay. However, the Court rejected the submission on the ground that mere knowledge of disputes does not constitute knowledge of fraud. Moreover, the Court found that the defendant had failed to establish fraud even before the Court and hence it concluded that the knowledge should be such that it is obvious and clear that there is fraud. In the words of the Court:

[137] Turkiye Is Bankasi v. Bank of China CLC 182 (1998)

> "As to the correspondence following the demands for payment under the PBs, I fully agree with the judge's analysis, and consider it falls fairly and squarely within Geoffrey Lane LJ's description of situation in the *Owen* case, i.e., it may be suspicious, and may indicate the possibility of sharp practice, but without anything remotely approaching true evidence of fraud or anything which makes fraud obvious or clear to the bank. Mere allegations of fraud or dishonesty (as were advanced here by both CSC and BOC) without any supporting evidence (as was also the case here), fall short of the necessary requirements."[138]

As is apparent, the requirement of knowledge of fraud does not mean mere communication of disputes in the underlying transaction but must be a clear and obvious evidence establishing fraud. The Court found that in the absence of such evidence, the bank is entitled to recover the money.

On the other hand, the issue of subsequent recovery from a fraudulent beneficiary by the confirming bank was considered in the interesting case of *Standard Chartered Bank v. Pakistan National Shipping Corporation*[139]. In this case, the bank sued the beneficiary as well as the shipping company seeking recovery of the money already paid under letter of credit. The case involved a clear fraud on part of the shipping company who had backdated the bills of lading to ensure its compliance with the letter of credit and the beneficiary had agreed to not seek payment till the shipping company actually shipped the consignment. In this case, the bank made the payment under letter of credit. Thereafter, it learnt of the fraud perpetrated by the beneficiary. The bank sought relief of damages from the shipping company and the beneficiary. In turn the defendants argued that the bank was not the person to whom the bill of lading was made and therefore, not within the class of persons to whom representation was made. However, the Court rejected the arguments and stated that:

[138] Turkiye Is Bankasi v. Bank of China CLC 182 (1998)

[139] Standard Chartered Bank v. Pakistan National Shipping Corporation Court of Appeal (Civil Division), 8th December 1995

> "it is said that the Standard Chartered Bank were not within the class of persons to whom representation in the bill of lading was made. I can say nothing in answer to that except that it is wrong. It was apparent on the face of the bill of lading that a letter of credit was involved. It must have been apparent to anybody with knowledge of the business of shipping that one or more intermediate banks might well be involved. There is nothing in that point.
>
> Then it is said that there was no reliance by Standard Chartered Bank on the statement in the bill of lading. That is an interesting point. Strictly speaking, it may well be true that Standard Chartered Bank did not rely on the fact asserted that the goods had been shipped by 25 October. What they relied on was the fact that in the bill of lading there was this statement that they had been shipped by that date. If the bill of lading had not said that, Standard Bank would have been entitled, and bound, to reject the documents and make no payment. It was the fact that that assertion was in the bill of lading which induced the Standard Chartered Bank to pay. That seems to me quite sufficient by way of reliance."[140]

The result being that the Court permitted the Bank to proceed for recovery of damages and emphatically rejected all the counter arguments presented on behalf of the shipping company and the beneficiary. The primary thrust of the Court was that mere representation to the bank through falsified documents constituted fraud on the bank in as much it is only once the fraudulent statement was made could the beneficiary encash the payment. Furthermore, by allowing the bank to proceed for recovery, the Court accepted that the bank retained its rights to seek recovery from the beneficiary. Eventually, the shipping company settled the case by making the full payment and the director of the beneficiary was found liable for the fraud perpetrated on the bank[141].

Thus, as can be seen the requirement of knowledge on the part of the banks remains central to securing restraining orders. This fits neatly with the principle of strict compliance that is, the

[140] Standard Chartered Bank v. Pakistan National Shipping Corporation Court of Appeal (Civil Division), 8th December 1995

[141] Standard Chartered Bank v. Pakistan National Shipping Corporation UKHL 43 (2002)

banks are not to look beyond the documents[142] nor are they concerned with investigating the background of the documents[143]. The banks are not required to look behind the documents but to merely asses their facial compliance with the terms of credit. And, when bank does make payment against fraudulent documents that were complying but the bank had no knowledge of fraud, then the banks remain protected[144]. However, the law does not leave parties without remedy. In case, the bank goes ahead with the payment well aware of fraud, then, the bank would not be able to seek reimbursement from the issuing bank or the applicant[145]. Similarly, the bank has been provided with remedy of providing evidence even during the proceedings requiring payment[146] and even, after the payment is made[147]. All this enables the banks to discharge their obligations and yet, remain protected in case they are defrauded.

I.3. EFFECT OF THIRD PARTY FRAUD: CURIOUS CASE OF *UNITED CITY MERCHANTS*

However, an outlier and yet one of the most cited decisions from the English Courts is that of *United City Merchants v. Royal Bank of Canada*[148]. The facts of the case are unique because

[142] UCP 600 Uniform Customs and Practice for Documentary Credits (2007 Revision) Article 34 states "A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person."

[143] Gao Xiang and Ross Buckley, "The Unique Jurisprudence of Letters of Credit: Its Origin and Sources", *San Diego Int'l L.J.* 4 (2003): 124

[144] Gian Singh v Banque de l'Indochine WLR 1234 (1974)

[145] As in Turkiye Is Bankasi v. Bank of China CLC 182 (1998) where the Court was willing to restrain the payment to the plaintiff bank but the defendant bank failed to show that there was strong evidence of fraud.

[146] Balfour Beatty Civil Engineering v. Technical and General Guarantee 68 Con LR 180 (1990)

[147] Standard Chartered Bank v. Pakistan National Shipping Corporation Court of Appeal (Civil Division), 8th December 1995

[148] United City Merchants v. Royal bank of Canada AC 168 (1983)

the beneficiary in the present case was wholly unaware of the fraud. Yet, this case since has spawned much controversy. The original buyer, Vitro was a company from Peru that contracted with an English company and accordingly opened a letter of credit in its favor through a local Peruvian bank which in turn was confirmed by the Royal Bank of Canada. The payment was to be made upon receipt of bills of lading for a shipment to be made on or before the 15th December 1976. Accordingly, the seller readied the goods to be shipped but the goods were not shipped till 16th December 1976 due to delay by the shipping company but the bill of lading was backdated by the shipping company. The ship chosen for carrying the shipment left on 16th December 1976. The plaintiff was the beneficiary's assignee who tendered the documents to the bank for payment. The bank refused to make the payment on the ground that the bill of lading was untrue in as much it did not accurately reflect the date of shipment. However, the House of Lords ordered the bank to release the payment stating that the beneficiary were innocent of the complained fraud. House of Lords stated that the payment had to be made. Lord Diplock in his reasoning based himself on the principle of apparent compliance of documents. He stated that:

> "It would be strange from the commercial point of view, although not theoretically impossible in law, if the contractual duty owed by confirming and issuing banks to the buyer to honour the credit on presentation of apparently conforming documents despite the fact that they contain inaccuracies or even are forged, were not matched by a corresponding contractual liability of the confirming bank to the seller/beneficiary (in the absence, of course, of any fraud on his part) to pay the sum stipulated in the credit upon presentation of apparently confirming documents."[149]

The Court's reliance on the ground of apparent conformity was to argue that the ambit of the bank's responsibility is limited to mere facial or visual verification of the document and that it is not concerned with carrying out investigation as to its genuineness or authenticity. Lord Diplock also answered the question raised by the defendants that presentation of documents

[149] United City Merchants v. Royal bank of Canada AC 168 (1983)

containing material misrepresentation as to the date of shipment constituted fraud by stating that:

> "It is conceded that to justify refusal the misstatement must be "material" but this invites the query: "material to what?" The suggested answer to this query was: a misstatement of a fact which if the true fact had been disclosed would have entitled the buyer to reject the goods; date of shipment (as in the instant case) or misdescription of the goods are examples. But this is to destroy the autonomy of the documentary credit which is its raison d'etre; it is to make the seller's right to payment by the confirming bank dependent upon the buyer's rights against the seller under the terms of the contract for the sale of goods, of which the confirming bank will have no knowledge."[150]

His reasoning was based on the principle of autonomy having centrality as in the claims of wrong description of the date of shipment. He reasoned that this inaccuracy belonged to the underlying contract where the buyer would have recourse to the seller under normal contractual obligations. Though, one might sympathize with the judgment that the bench prevented the applicant for avoiding their payment obligation for a mere delay of one day[151], however, the rationale of *innocent beneficiary* is not very inspiring.

It is submitted that the above decision, though, relies upon the ground of *innocent beneficiary*, but has overstretched the principle of conformity and autonomy. If this approach is extended, then, parties would be able to demand payment from the banks by merely presenting confirming documents.[152] Therefore, it is necessary that the fraud rule must apply in as much it should be the nature of the documents that must be relevant and determining factor rather than identity of the party.[153]Furthermore, though, the banks are concerned only with the facial

[150] United City Merchants v. Royal bank of Canada AC 168 (1983)

[151] Guy Lewin Smith, "Irrevocable Letters of Credit and Third Party Fraud: The American Accord", *Va. J. Int'l L.* 24, no. 1 (1983): 72

[152] Kieran Donnelly, "Nothing for Nothing: A Nullity Exception in Letters of Credit?" *Journal of Business Law* 4 (2008): 339

[153] Gao Xiang "The Identity of the Fraudulent Party Under the Fraud Rule in the Law of Letters of Credit" *University of New South Wales Law Journal* 24, no. 1 (2001)

appearance of the documents, that is, they are required to only visually inspect the documents and not go into their genuineness or authenticity, yet, as discussed earlier, the element of knowledge plays a key role. The element of knowledge on part of the bank assumes significance because the bank would in turn seek reimbursement either from the applicant of credit or the issuing bank[154]. This would not be the case if it is aware that the documents are fraudulent[155]. That is, when the bank itself is aware that the documents tendered are fraudulent, then in such cases it should be entitled to refuse the documents irrespective of the claimant's innocence[156]. Such rule is also beneficial as it would incentivize the beneficiary to properly scrutinize the documents prior to their presentation and entry into the commercial chain[157]. The above position is also reiterated by Professor Goode[158]:

> "Unfortunately, English courts have become so beguiled by the autonomy principle that they decline to allow refusal of payment in favour of a beneficiary acting in good faith even where the documents are forged or otherwise fraudulent, on the supposed principle that the beneficiary's duty is to tender documents which appear to conform to the credit, even if they are in fact fraudulent and worthless. Such an approach, far from enhancing the documentary credit system, does a disservice to its integrity, and it will be argued a little later that it is high time it was abandoned."

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[154] Charl Hugo, "Documentary Credits: Apparently Conforming Documents Equals Conforming Documents - The Bizarre Heritage of United City Merchants (Investments) Ltd v Royal Bank of Canada", *S. Afr. Mercantile L.J.* 13 (2001): 600 states "the defence raised by the bank in the United City Merchants case has nothing to do with the fraud exception to the independence principle. There is no need to seek an exception from the independence principle in this situation. The bank's defence is derived from its own contract with the beneficiary. In terms of this contract, the bank is only liable to perform if, in the words of the UCP, 'the stipulated documents' are presented (see art 9). This term, it is suggested, does not mean documents that merely conform on their face, but valid documents without any misrepresentations."

[155] GKN Contractors v. Lloyds Bank 30 BLR 48 (1985)

[156] Gao Xiang "The Identity of the Fraudulent Party Under the Fraud Rule in the Law of Letters of Credit" *University of New South Wales Law Journal* 24, no. 1 (2001): 137; Paul Todd, *Bills of Lading and Bankers Documentary Credits* (London: Informa, 2007), 254 quoting Professor Schmitthoff states that the "[banks] will not like the idea that they have to honour a credit although they know that the documents tendered are fraudulent, only because it cannot be proved, before the credit is honoured, that the seller is aware of the fraud.''

[157] Gao Xiang "The Identity of the Fraudulent Party Under the Fraud Rule in the Law of Letters of Credit" *University of New South Wales Law Journal* 24, no. 1 (2001): 139

[158] Roy Goode, *Commercial Law* (London: Penguin, 2004), 972

In other words, when the banks are aware of the fraud in the documents, then, they should be entitled to reject honoring them and the state of mind of the seller – whether he is aware of fraud or not – should not play a role in the bank's decision[159]. To sum up, it is no argument that the documents that are presented by beneficiary are complying merely because the beneficiary himself is unaware or himself did not partake in the fraud. As Professor Goode put it:

> "Let us start with the beneficiary. He himself has a duty to tender documents which are in order, and the fact that he acted in good faith in tendering forged documents is thus irrelevant. …. The beneficiary under a credit is not like a holder in due course of a bill of exchange; he is only entitled to be paid if the documents are in order. A fraudulently completed bill of lading does not become a conforming document merely because the fraud is that of a third party."[160]

To sum up, by permitting payment against fraudulently complied documents, the Court has left a gaping hole in the law. This effectively militates against the entire body of law that prohibits fraud in the documents as well as entitles bank to refuse payment in case it has knowledge of fraud in the documents. Therefore, it is humbly submitted, that this decision should continue to inspire respect in respect of its enunciation of principles of letter of credit but not for the exception that it has unwittingly created.

I.4. THE LETTER OF CREDIT ITSELF AN OUTCOME OF FRAUD

The above cases discuss the question of fraud with respect to allegations of fraud done by the beneficiary but as the following cases would show, there have been cases where the banks

[159] Guy Lewin Smith, "Irrevocable Letters of Credit and Third Party Fraud: The American Accord", *Va. J. Int'l L.* 24, no. 1 (1983): 62 states "The state of mind of the seller should not affect the issue, which is purely one of documentary validity. If a bank refuses to pay against documents which are in fact genuine, although the bank honestly believed them forged, it has no defense to the seller's action for wrongful repudiation. Similarly, the seller's beliefs should be irrelevant to the issue. The seller is under a duty in the credit transaction, just as he is in the sales context, to tender documents which conform on their face to the credit requirements and which are genuine and valid. If he has done so, he has an absolute right to be paid. If he has not done so, despite his belief that he has, he does not have the right to be paid."

[160] Roy Goode, "Reflections on Letters of Credit – I", *Journal of Business Law* (1980): 291

refused payment after they learnt that the securing of the letter of credit itself was tainted with fraud.

In the case of *Safa v. Banque Du Caire*[161], the Court was confronted with refusal by the bank to pay on the letters of credit issued by it in favor of the assignee of the beneficiary. The Plaintiff was the assignee of the beneficiary. Briefly, the letters of credit were opened in favor of the beneficiary so that the beneficiary may pay for the premium of counter-guarantees in favor of the bank that in turn would rely upon these counter-guarantees to advance loan to the applicant. However, it was discovered by the bank that the premium on the counter-guarantee was about half the amount of the letter of credit and substantial proceeds were arranged to be transferred to wholly unknown third party. The Court found that the entire transaction was not consistent with honest dealing and found that the letters of credit were being used as a vehicle for fraud.

In another case of *Solo Industries v. Canara Bank*[162], the Court was confronted with a similar situation of beneficiary being accused of using the banking system as a vehicle for fraud with the bank resisting payment. The plaintiff was the beneficiary under the performance bond issued by the defendant bank on behalf of the seller. The plaintiff was the buyer. The plaintiff demanded payment under the performance bond stating that the seller had defaulted. However, the bank sought to avoid payment contending that the underlying contract was a sham and that the bond itself was the result of a fraudulent conspiracy between the beneficiary-buyer and the applicant-seller[163]. In effect, the bank argued that it's challenge lay

[161] Safa v. Banque Du Caire Lloyd's Rep 600 (2000) (The bank had agreed to advance loan to Aboul Fotouh for 50 million dollars for which he was to arrange counter-guarantees in favor of the bank. Aboul Fotouh secured the assistance of the original beneficiaries, Paul Group, by issuing letters of credit totaling 9.25 million dollars to pay the premium to the party issuing the counter-guarantee.)

[162] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[163] Solo Industries v. Canara Bank All ER (D) 34 (2001) (Briefly, the beneficiary was the buyer who was also the plaintiff in the present suit. The seller was the applicant for the performance bond. The bond was a

upon the validity of the bond and not to the propriety of demands under it. The Court cited the *Safa*[164] decision with approval stating that "*in principle a misrepresentation inducing the opening of a credit may give rise to a defence or other compelling reason for trial*"[165]. The Court further continued to distinguish the present case from other cases where the ground of fraud is used to resist payment in the words:

> "Banks also accept the risk that they may have to make a payment, that they cannot later recover from their customer if their customer defaults and becomes insolvent. The cash principle means that (short of established fraud) any claim that a bank acquire against a beneficiary making a fraudulent demand must be pursued separately and subsequent to payment, and cannot normally be used as a defence or set off to avoid payment. All that is clear. But such risks all arise out of and on the basis of the instruments issued. They assume the "integrity" of the instrument that the bank has issued.
>
> It does not follow that banks accept the risk that the instrument itself has been induced by conspiracy between, or misrepresentation by, their customers and the beneficiaries. The mere appearance of a valid instrument cannot commit a bank." [166]

Consequently, the Court refused to grant the prayer of the plaintiff to compel the bank to release the payment. The above two cases do not concern allegation of fraud whereby beneficiary has indulged in misrepresentation as to the terms of the credit but go to the root of the matter whereby the validity of the instrument itself is denied. These cases involve banks denying obligation to part with their money on account of the instruments being used as so to say "vehicles for fraud". In such cases, the Courts have found that the bank is entitled to

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performance bond to be paid upon being called by the beneficiary for default of sale obligations by the seller. The bank contended that there was an elaborate scheme whereby forged documentation were being used by the person controlling the two entities as well as other intermediaries. The bank further placed on record large volume of evidence showcasing the hollowness of claims of existence of mines in favor of the seller in India as well as pendency of parallel proceedings against the parties in various jurisdictions were forged shipping documents and other documents were recovered.)

[164] Safa v. Banque Du Caire Lloyd's Rep 600 (2000)

[165] Safa v. Banque Du Caire Lloyd's Rep 600 (2000)

[166] Solo Industries v. Canara Bank All ER (D) 34 (2001)

refuse payment where it can show that the opening of these instruments with the bank was done on basis of misrepresentation to deprive the bank of its money.

I.5. STANDARD OF PROOF TO ESTABLISH FRAUD

This leads to the next question as to what constitutes established fraud. That is, at what point would the Court consider that the evidentiary burden has been discharged so as to show that the documents presented by the beneficiary are in fact fraudulent and should not be honored.

The Court extensively considered the issue of standard of proof for establishing fraud in the case of *Edward Owen v. Barclays Bank*[167] where the plaintiff alleged that non-performance under the contract amounted to fraud by the defendant-buyer effectively disentitling them from seeking payment under the performance guarantee. However, the Court after considering the conduct of the parties in the underlying transaction and the case of the plaintiff concluded that such conduct constituted fraud:

> "it is certainly not enough to allege fraud; it must be "established," and in such circumstances I should say very clearly established.
>
> ….
>
> I disagree that that amounts to any proof or evidence of fraud. It may be suspicious, it may indicate the possibility of sharp practice, but there is nothing in those facts remotely approaching true evidence of fraud or anything which makes fraud obvious or clear to the bank. Thus there is nothing. It seems to me, which casts any doubt upon the bank's prima facie obligation to fulfil its duty"[168]

In this way, the Court laid down that the standard of proof for establishing fraud is that the fraud is to be *clearly established* and such proof or evidence will not be considered clearly established merely on account of suspicion or sharp practice.

[167] Edward Owen v. Barclays Bank 1 QB 159 (1978)

[168] Edward Owen v. Barclays Bank 1 QB 159 (1978)

The above position was reiterated in the case of *United Trading v. Allied Arab Bank*[169] where the plaintiff had requested a performance bond to be issued through its bank which was arrayed as the defendant which in turn acquired it from Rafidain Bank in favor of Agromark who was the buyer. Agromark made demand on the payment guarantee on account of differences with the plaintiff in the underlying contract and the plaintiff fearing that it would have to pay Agromark brought an action against the bank seeking restraining orders. However, the Court refused to grant the injunction on the basis that the plaintiff failed to establish fraud. The Court clarified the evidentiary requirements to establish fraud in the words:

> "The evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge. The mere assertion or allegation of fraud would not be sufficient. We would expect the court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. If the court considers that on the material before it the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud."[170]

Therefore, the Court's approach can be said that the party asserting fraud to prevent a payment obligation to be carried out must clearly establish fraud supported by strong corroborative evidence in the form of contemporary documents and that mere assertion or allegation of fraud would not be sufficient. Thus, the evidentiary requirements to establish fraud before English Courts remain very high.[171]

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[169] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

[170] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

[171] Ross P. Buckley and Xiang Gao, "Development of the Fraud Rule in Letter of Credit Law: The Journey So Far and the Road Ahead", *U. Pa. J. Int'l L.* 23, no. 4 (2002): 690

However, the English Courts recognize different stages at which the parties may seek such restraining orders or directions to the bank to make payment in case of refusals by the bank. That is, the proceeding might be at the interim stage prior to the trial or the Court maybe considering the question at full trial. Or still the proceeding might be that of one under the summary judgment procedure. The Courts have crafted different tests for each of the stage or the proceeding that is before it. This fits well with the expectation that the requirement of evidence to obtain interlocutory / interim injunction prior to trial cannot be identical with obtaining final injunction subsequent to trial[172].

a. <u>At the Interim Stage before the trial has been conducted</u>

In all cases involving restraint of payment, the plaintiff seeks an interim injunction till the pendency of the suit so as to prevent the payment from being made during the course of proceedings. The Court has, therefore, been called upon to lay down the evidentiary standards to establish fraud. Though, English Courts ordinarily follow the three test laid down in *American Cyanamid v. Ethicon*[173] , the Courts have clarified that cases concerning letters of credit are special cases as special factors that apply in such cases[174]

In *Bolivinter Oil v. Chase Manhattan Bank*[175], the Court specifically laid down the standard of proof to be followed at the interim stage. It stated that:

> "an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to

[172] Roy Goode, "Reflections on Letters of Credit – I", *Journal of Business Law* (1980); Simon Carves Limited v. Ensus UK Limited EWHC 657 (2011); Czarnikow-Rionda Sugar Trading v. Standard Bank London Lloyd's Rep 187 (1999)

[173] American Cyanamid v. Ethicon AC 396 (1975)

[174] Simon Carves Limited v. Ensus UK Limited EWHC 657 (2011)

[175] Bolivinter Oil v. Chase Manhattan Bank WLR 392 (1984)

the bank's knowledge. It would certainly not normally be sufficient that this rests upon the uncorroborated statement of the customer."

The test that the Court has propounded categorically excludes any uncorroborated statement from being considered while emphasizing that the evidence of fraud must be clear. The test for assessment whether the evidence is sufficient to establish fraud was laid down in by *United Trading v. Allied Arab Bank*[176]where the Court after examining the evidence laid down that the party seeking restraining orders must show "*on the available material*"[177] a seriously arguable case that "*the only realistic inference is that the demands were fraudulent*"[178]. This approach was approved in *Group Josi v. Walbrook Insruance*[179] where the Court interpreted the above decision to mean that the *Cyanamid* test in relation to pre-trial injunction would require consideration as "*Have the plaintiffs established that it is seriously arguable that, on the material available, the only realistic inference is that [the beneficiaries] could not honestly have believed in the validity of its demands on the performance bonds?*"[180] The Courts have also clarified that the standard of proof remains lower at the pre-trial stage and does not warrant the same evidentiary requirement as in the post-trial hearing. However, the Court in *Czarnikow-Rionda Sugar Trading v. Standard Bank London*[181]found that this reduction on the standard of proof is also followed by an extra consideration of balance of convenience where the Court has to examine the effect of the commitment made by the bank. In the words of Rix J.:

[176] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

[177] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

[178] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

[179] Group Josi v. Walbrook Insurance 4 All ER 181 (1994)

[180] Group Josi v. Walbrook Insurance 4 All ER 181 (1994)

[181] Czarnikow-Rionda Sugar Trading v. Standard Bank London Lloyd's Rep 187 (1999)

> "the fact that the claimants gets the benefit of a lower standard of proof for the purposes of pre-trial hearing, places on the court, as I believe the cases demonstrate, an additional requirement to be careful in its discretion not to upset what is in effect a strong presumption in favour of the fulfilment of the independent banking commitments"[182]

He reasoned this on the ground that:

> "the competing interests become the importance to international trade of the integrity and autonomy of banking commitments on the one hand, and the demands of the allegedly defrauded claimant …I say 'allegedly defrauded' because, first, ex hypothesi what the claimant alleges to have been a clear case of fraud has not been accepted as such by his bank, and secondly, the matter has to be dealt with at a pre-trial stage."[183]

The Privy Council in the 2014 judgment of *Alternative Power Solutions v. Central Electricity Board*[184]was specifically asked to comment upon the standard of proof to be employed at the interim injunction / pre-trial stage. The Privy Council after considering the above-mentioned authorities concluded that the test described by Ackner LJ in *United Trading v. Allied Arab Bank*[185] is the correct one and that it is more stringent than the ordinary interim injunction standards of "good arguable case" or "serious issue to be tried". In its words, it held that:

> "It recognises that the test cannot be quite the same as at a trial and that the test at the interlocutory stage can properly be described as Ackner LJ described it, namely whether it is seriously arguable that, on the material available, "the only realistic inference is that [the beneficiary] could not honestly have believed in the validity of its demands on the performance bonds" and that the bank was aware of that fact. In the view of the Board the expression "seriously arguable" is intended to be a significantly more stringent test than good arguable case, let alone serious issue to be tried. As Mance LJ put it, a case of established fraud known to the bank, is, by its nature, one which, if it is good at all, must be capable of being established with clarity at the interlocutory stage. In summary, the Board concludes that it must be clearly established at the interlocutory stage that the

[182] Czarnikow-Rionda Sugar Trading v. Standard Bank London Lloyd's Rep 187 (1999)

[183] Czarnikow-Rionda Sugar Trading v. Standard Bank London Lloyd's Rep 187 (1999)

[184] Alternative Power Solutions v. Central Electricity Board [2014] UKPC 31

[185] United Trading v. Allied Arab Bank Lloyd's Rep. 554 (1985)

only realistic inference is (a) that the beneficiary could not honestly have believed in the validity of its demands under the letter of credit and (b) that the bank was aware of the fraud."[186]

Thus, the party seeking restraint on payment on a letter of credit is required to overcome the hurdle of showing that it has a seriously arguable case where the only realistic inference is that there is fraud. Such a requirement is considered higher than the ordinary standards.

b. <u>At the Final Stage after the trial has been conducted</u>

However, the English Courts have taken a different view when it comes to the final hearing. The Courts have clarified that the benefit that is available to the party seeking restraint at the pre-trial stage is no longer available at the final hearing[187]. The Courts have recognized that the requirement of standard of proof of clear and established fraud applies in full force at the final stage and that no lowering of standard is permissible on any other ground[188]. Therefore in the case of *Turkiye Is Bankasi v. Bank of China*[189] where the defendant bank was refusing to reimburse the plaintiff bank on the ground of fraud was found to have failed to establish a clear case of fraud. The Court after reviewing the evidence found that the plaintiff though was made aware of disputes in the underlying contract but yet, such disputes did not themselves establish that there was fraud. The Court relying upon *Edward Owen Engineering*[190] concluded that:

"it may be suspicious, and may indicate the possibility of sharp practice but without anything remotely approaching true evidence of fraud or anything which makes fraud obvious and clear to the bank. Mere allegations of fraud or

[186] Alternative Power Solution v. Central Electricity Board UKPC 31 (2014)

[187] Simon Carves Limited v. Ensus UK Limited EWHC 657 (2011)

[188] Czarnikow-Rionda Sugar Trading v. Standard Bank London Lloyd's Rep 187 (1999)

[189] Turkiye Is Bankasi v. Bank of China CLC 182 (1998)

[190] Edward Owen v. Barclays Bank 1 QB 159 (1978)

dishonesty (as were advanced here by [defendants]) without any supporting evidence (as was also the case here), fall far short of the necessary requirements."

Therefore, the Courts continue to rely upon the standard of clear established fraud at the final hearing. That is, the party resisting payment must clearly establish existence of fraud at the stage of final hearing. In its absence, it would be directed to make the payment and would not be permitted to resile away from its obligations.

c. <u>In a summary judgment proceedings</u>

English procedure also admits of summary judgment where the plaintiff may seek summary judgment against the defendants without the necessity of going through trial under rule 24.2 of the Civil Procedure Rules. The rule states that:

> "The court may give summary judgment against a claimant or defendant on the whole of a claim or on a particular issue if –
>
> (a) it considers that –
>
> (i) that claimant has no real prospect of succeeding on the claim or issue; or
>
> (ii) that defendant has no real prospect of successfully defending the claim or issue; and
>
> (b) there is no other compelling reason why the case or issue should be disposed of at a trial."[191]

In such cases, the Courts have consistently applied the test of "no real prospect of success" in favor of the defendants who are resisting the obligations to make payment.

In the case of *Safa v. Banque du Caire*[192], the Court was faced with the summary judgment procedure against the bank by the beneficiary of letter of credit but refused to grant summary

[191] Civil Procedure Rules, Rule 24.2

[192] Safa v. Banque Du Caire Lloyd's Rep 600 (2000)

judgment by considering the evidence and finding that "*the bank does have real prospect of success on the fraud point*"[193].

The question of the applicable standard in a summary judgment proceeding came up again in the case of *Solo Industries v. Canara Bank*[194], the Court was confronted with the question of what constitutes a proper standard of proof when the validity of the letter of credit was itself under challenge. The Court after referring to multiple cases concluded that when the challenge lies to the validity of the instrument itself, then, then "*the test or burden equivalent to that under the fraud exception*"[195] does not apply and that the defendant is required to show real prospect of success. Consequently, the Court refused the summary judgment by acknowledging that the defendant bank had sufficiently established that there was a real prospect of success when the matter goes to trial.

The Court in *Banque Saudi Fransi v. Lear Siegler Services*[196] finally clarified that even for fraud exception to the payment, the appropriate test for refusal of summary judgment requiring payment would be that provided under rule 24.2 of Civil Procedure Rules. The Court concluded that the appropriate test would be to assess whether the party resisting payment would be able to show that there is a real prospect that it will be able to prove the fraud exception at trial. The Court concluded by adding that "*this is a high hurdle to meet at trial*" as at trial would it would be required to show that "*the evidence of fraud [is] clear, both as to the fact of fraud and as to the bank's knowledge*".

[193] Safa v. Banque Du Caire Lloyd's Rep 600 (2000)

[194] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[195] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[196] Banque Saudi Fransi v. Lear Siegler Services EWCA Civ 1130 (2006)

This position was further reiterated in the case of *Enka Insaat Ve Sanayi v. Banca Popolare Dell'Alto Adige*[197] where the banks resisted payment pleading fraud exception. The Court allowed the summary judgment finding that the facts did not establish fraud because the banks failed to establish that it had real prospect of success. The Court stated that "*the test in the present context is whether there is a real prospect that the Banks will establish at trail that the only realistic inference is that the fraud exception applies*"[198].

Lastly, the question as to the relationship between the test under the interim injunction and the one for summary judgment was placed before the Court in the case of *National Infrastructure Development Company v. Banco Santander*[199] where the Court of Appeal was confronted with the question whether the test of seriously arguable case as held under the interim injunction standard was the correct one for summary judgment. Briefly the case involved the Appellant who was the beneficiary under the letter of credit issued by the bank. The Appellant sought payment under the letters of credit but the bank resisted the payment stating that the claim for payment was fraudulent. The appellant brought a summary judgment against the bank seeking payment under the letters of credit. The lower Court in *National Infrastructure Development Company v. Banco Santander*[200] rejected the defense of the bank on the ground that the bank failed to establish that it had a seriously arguable case. The Court after referring to *Alternative Power* judgment and the judgment in *Solo Industries* concluded that the phrase:

> "seriously arguable … was used appropriately to describe the burden on a claimant seeking to establish acclaim for interim relief in the form of an interlocutory injunction; but the phrase is, with respect to the judge, not

[197] Enka Insaat Ve Sanayi v. Banca Popolare Dell'Alto Adige EWHC 2410 (2009)

[198] Enka Insaat Ve Sanayi v. Banca Popolare Dell'Alto Adige EWHC 2410 (2009)

[199] National Infrastructure Development Company v. Banco Santander EWCA Civ 27 (2017)

[200] National Infrastructure Development Company v. Banco Santander EWHC 2990 (2016)

> appropriate to describe the burden on a defendant seeking to resist summary judgment who only has to establish a "real prospect" of establishing his defence ….. The use of phrase "seriously arguable" may have been an inadvertent infelicity in the course of an unreserved judgment. But the judge appears to have set the bar too high and this ground of appeal, so far as it goes, must succeed."[201]

Thus, the Court clarified that the appropriate standard in summary judgment application to argue fraud exception to payment is that of real prospect of success and that this requirement is considered lower than the one required under the pre-trial interim injunction cases.

This position also appears a correct one because when Court is asked to interfere in payment obligation, it ought to be sufficient to show that there is a real prospect of success by the defendant. This is because the claimant by bringing in a summary judgment application is attempting to forego trial and in effect demanding a final judgment without the benefit of trial or cross-examination. Thus, it is both fair and necessary that the defendant should be able to halt such an extraordinary relief at a lower standard of proof. On the other hand, the party seeking interference at the interim stage, where the trial is still pending and there is no deprivation of cross-examination, there continues to remain the heightened test of showing a seriously arguable case that the only realistic inference is fraud.

To sum up, it is apparent that the English Courts approach interference in payment obligations very restrictively and conservatively. The fraud exception in itself is a heightened test demanding a clear showing of fraud in documents coupled with the knowledge of bank at the appropriate time. Furthermore, the standard of proof continues to remain that of clear and established fraud albeit adjusted to certain extent for different stages of the case.

[201] National Infrastructure Development Company v. Banco Santander EWHC 2990 (2016)

II. THE NULLITY EXCEPTION: TO BE OR NOT TO BE

The other exception that has been put forward before the Courts as a ground to interfere with the obligations under letters of credit is the nullity exception[202]. Nullity exception comes into play when a document that is presented for compliance is null and void. This leads to two key questions: is there a nullity exception to principle of autonomy and if so, what constitutes the ingredients for establishing nullity.

One of the earlier cases where the question of what makes a document nullity came up before the Court in the case of *Kreditbank Cassel v. Schenkers*[203] where the question arose that where a bill of exchange was issued as a result of forgery, then, whether the company would be required to reimburse the holder of the bill of exchange. The Court concluded that no such liability arose because the forged document was considered pure nullity.

Later, the Court was confronted with a similar question as to whether the document presented constitutes nullity in *Chao v. British Traders and Shippers*[204] where the plaintiff-buyer brought a case for breach of the contract of sale that the bill of lading was nullity as it was backdated by the defendant-seller. The plaintiff's key assertion was that because of the backdating, the bill of lading so presented was forged and therefore, a nullity. The Court citing the decision in *Kreditbank Cassel v. Schenkers*[205] stated that

> "If someone forges the signature to a document, that document is wholly fictitious from beginning to end, and it is, of course, null and void as soon as forgery is proved, but I do not think that that is any authority for the view that any material alteration to a document destroys it and renders it null and void. Deciding the matter in the absence of authority and on principle, I think the true

[202] Montrod v. Grundkotter All ER (D) 335 (2001)

[203] Kreditbank Cassel v. Schenkers KB 826 (1927)

[204] Chao v. British Traders and Shippers QB 459 (1954)

[205] Kreditbank Cassel v. Schenkers KB 826 (1927)

> view is that one must examine the nature of the alteration and see whether it goes to the whole or to the essence of the instrument, or not. If it does, and if the forgery corrupts the whole of the instrument or its very heart, then the instrument is destroyed, but if it corrupts merely a limb, then the instrument remains alive, though, no doubt, defective. … Accordingly, in my judgment, the bill of lading in the present case was not a nullity, and the submission of counsel for the defendants on that point is right."

As a conclusion, the Court declined the finding in favor of the plaintiff-buyer that the alteration in the bill of lading constituted forgery and thus, rendered the bill of lading a nullity.

The genesis for consideration of this exception with respect to payment obligations under letter of credit arises in the dicta of Lord Diplock in the *United City Merchants*[206] case where in his analysis of the bill of dating he stated:

> "I would not wish to be taken as accepting that the premiss as to forged documents is correct, even where the fact that the document is forged deprives it of all legal effect and makes it a nullity, and so worthless to the confirming bank as security for its advances to the buyer. … I would prefer to leave open the question of the rights of an innocent seller/beneficiary against the confirming bank when a document presented by him is a nullity because unknown to him it was forged by some third party; for that question does not arise in the instant case. The bill of lading with the wrong date of loading placed on it by the carrier's agent was far from being a nullity. It was a valid transferable receipt for the goods giving the holder a right to claim them at their destination, Callao, and was evidence of the terms of the contract under which they were being carried."[207]

Lord Diplock, as can be seen above, states that he is leaving the question of what constitutes nullity but he also assesses the bill of lading as not being a nullity. That is, he has come to the same finding as in the *Chao*[208] case where the Court found that backdating of the bill of lading did not render it nullity and thus, entitling the buyer-plaintiff to recover damages.

[206] United City Merchants v. Royal bank of Canada AC 168 (1983)

[207] United City Merchants v. Royal bank of Canada AC 168 (1983)

[208] Chao v. British Traders and Shippers QB 459 (1954)

The question of ambit of the nullity exception was thereafter considered by the Court in the case of *Montrod v. Grundkotter*[209] where the plaintiff brought the case against the seller and the banks seeking restraint from payment on the ground that the documents that were presented to the banks were nullity as being non-conforming document. The question that was formulated by the Court was "*If, by the time of full payment (or the time when a bank irrevocably commits itself to a third party who has taken in good faith, if earlier), the only reasonable inference is that one (or more) of the documents […] presented under the credit is not what it appears on its face to be, but is a nullity, then the bank is not obliged to make payment under the credit*"[210]. The facts showed that the seller had signed on the inspection certificate himself and presented it to the bank for payment whereas the plaintiff contended that such inspection certificate had to be signed by the plaintiff as per agreement. The plaintiff relying upon the judgment of Lord Diplock in the *United City Merchants*[211] argued that the letters of credit admitted another exception beyond the fraud exception because null documents like the fraudulent documents are worthless and has no commercial value to hold as security for goods. The Court however rejected the submission and stated:

> "While [Lord Diplock] left open the position in relation to a forged document where the effect of the forgery was to render the document a 'nullity', there is nothing to suggest that he would have recognized any nullity exception as extending to a document which was not forged (ie fraudulently produced)"[212]

The Court reasoned that the banks are not required to conduct any inquiry beyond what appears on the face of the document. The Court further reasoned that it was not inclined to find an additional ground for interfering in the payment obligations in view of absence of any

[209] Montrod v. Grundkotter All ER (D) 335 (2001)

[210] Montrod v. Grundkotter All ER (D) 335 (2001)

[211] United City Merchants v. Royal bank of Canada AC 168 (1983)

[212] Montrod v. Grundkotter All ER (D) 335 (2001)

precise meaning as to what would render a document 'nullity'. In this manner, the Court specifically held that there is no general exception to nullity and at most the Court would admit of a fraudulent document under the accepted standards for fraud exception.

What in effect, *Montrod*[213] judgment held that if the document presented for compliance is fraudulent or forged, then, such would be a ground for refusal under the fraud exception itself but absence such a fraud, the Court would not admit of a general nullity exception. However, the case has been criticized for this view. The reason being that the banks are required to pay under conforming documents and not merely against those that appear to conform especially after they learn that the document so presented is merely facially compliant. This assumes significance because the bank would in turn seek reimbursement but holding a "*worthless piece of paper does not improve its position*"[214]. There has been further criticism in that by permitting documents that are worthless to be taken by the banks, the Court in effect is sanctifying "*circulation of such documents [that] will undermine the trust that is the foundation of trade*"[215]. That is, the principle of autonomy that protects the seller and the letter of credit from the underlying contract should not be extended to mean to protection from defenses raised on the ground of documents themselves[216]. That is, if a document is a nullity and merely conforms facially to the terms of credit, then, it should not matter whether such nullity arose as a mistake or fraud[217].

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[213] Montrod v. Grundkotter All ER (D) 335 (2001)

[214] Richard Hooley, "Fraud and Letters of Credit: Is There a Nullity Exception?" *Cambridge Law Journal* 61, no. 2 (2002): 280-281

[215] Richard Hooley, "Fraud and Letters of Credit: Is There a Nullity Exception?" *Cambridge Law Journal* 61, no. 2 (2002): 281

[216] Dora Swee Suan Neo, "A Nullity Exception in Letter of Credit Transactions?" *Singapore Journal of Legal Studies* 46 (2004): 67

[217] Dora Swee Suan Neo, "A Nullity Exception in Letter of Credit Transactions?" *Singapore Journal of Legal Studies* 46 (2004): 68

Therefore, it appears that the nullity exception in effect is being construed as the one restricted to where the document so presented for compliance is forged. In an analysis of *United City Merchants*[218] and *Montrod*[219] cases, the Singapore Court of Appeal in the case of *Beam Technology v. Standard Chartered Bank*[220] where the Court was confronted with the question of what is a nullity exception and does it constitute an exception sufficient enabling a Court to interfere with banking obligation. The Court after considering both the English authorities concluded that the bank is not obliged to pay when it is aware that the apparently confirming document is a forgery rendering it null and void. In the words of the Court:

> "But we are unable to see why such a rule should also lead to the result that if the confirming or negotiating bank, from whatever source, is able to establish within the prescribed seven day limit that a material document tendered is a forgery, being null and void, the bank is nevertheless obliged to pay."[221]

Thus, the conclusion of the Court was that where the party seeking restraint against payment obligations under letter of credit establishes that the document presented as compliance under terms of credit is a forgery rendering it null, then, the Court can restrain payment.

It is submitted that *Beam Technology*[222] though recognizes the nullity exception. However, by restricting its scope to the narrow ground that the document ought to be forged effectively brings the nullity exception within the fraud exception itself. This is because a forged

[218] United City Merchants v. Royal bank of Canada AC 168 (1983)

[219] Montrod v. Grundkotter All ER (D) 335 (2001)

[220] Beam Technology v. Standard Chartered Bank SGCA 53 (2002)

[221] Beam Technology v. Standard Chartered Bank SGCA 53 (2002)

[222] Beam Technology v. Standard Chartered Bank SGCA 53 (2002)

document as was the case in *Standard Chartered Bank v. Pakistan National Shipping Corporation*[223] would be sufficient to establish fraud.

III. THE ILLEGALITY EXCEPTION: THE CASE OF KALASHNIKOVS?

The exception of illegality to letter of credit refers to illegality in the underlying contract rather than illegality in the letter of credit itself as was the case in *Safa*[224] and *Solo Industries*[225]. The essential aspect of illegality exception is that the payment obligation is sought to be halted on the ground that such payment would be for furtherance of an illegal contract.

The earliest exposition as to whether illegality of the underlying transaction can be considered a ground for interfering with letter of credit was considered by Staughton LJ in the case of *Group Josi v. Walbrook Insurance*[226] where he considered a hypothetical case of sale of Kalashnikov rifles to Iraq and the seller bringing a case seeking payment. He opined that in such a situation illegality would affect the enforcement of letter of credit. In his words:

> "there must be cases when illegality can affect a letter of credit. Take for example a contract for the sale of arms to Iraq, at a time when such a sale is illegal. The contract provides for the opening of a letter of credit, to operate on presentation of a bill of lading for 1,000 Kalashnikov rifles to be carried to the port of Basra. I do not suppose that a court would give judgment for the beneficiary against the bank in such a case."[227]

[223] Standard Chartered Bank v. Pakistan National Shipping Corporation Court of Appeal (Civil Division), 8th December 1995

[224] Safa v. Banque Du Caire Lloyd's Rep 600 (2000)

[225] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[226] Group Josi v. Walbrook Insurance Lloyd's Rep 345 (1996)

[227] Group Josi v. Walbrook Insurance Lloyd's Rep 345 (1996)

Thus, on principle basis, the Court accepted the proposition that if the underlying contract is illegal, then, the Court would not coerce the bank into payment.

Subsequently, in the case of *Mahonia v. JP Morgan Chase Bank*[228], Colman J. expressly recognized the existence of illegality defense in a letter of credit obligation. After considering the *Group Josi*[229] case, he held that:

> "The transaction is therefore similar in many ways to one in which the underlying contract is illegal to the knowledge of both parties and therefore unenforceable by either and where one of the parties to it procures an innocent third party to provide to the other a bond which pays against a certificate that the underlying contract has not been performed. Leaving aside the additional feature of a letter of credit, the authorities discussed in paragraphs (21 to 27) above support the proposition that the innocent third party could rely by way of defence on the underlying illegality. The position would be no different if the underlying contract were legal on its face but entered into for an illegal purpose or if the underlying contract were illegal because it required the carrying out of an act in the United States which was unlawful there or was for the purpose of the carrying out of such an act."[230]

The Court by above reasoning emphatically accepted that the illegality exception to payment obligation under letter of credit existed under the English law and that such a defence could be set-up. The Court's reasoning lay in the analogy with the fraud exception where the Court stated that just as there is strong public policy consideration in preventing fraud. Similarly, the Court found that there is strong public policy consideration in ensuring that the banking machinery is not employed to perpetrate illegal conduct.

Later, the Court in *Mahonia v. JP Morgan Chase Bank*[231] after considering the entirety of evidence answered the question whether the letter of credit was for the purpose to enable the

[228] Mahonia v. JP Morgan Chase Bank EWHC 1927 (2003)

[229] Group Josi v. Walbrook Insurance Lloyd's Rep 345 (1996)

[230] Mahonia v. JP Morgan Chase Bank EWHC 1927 (2003)

[231] Mahonia v. JP Morgan Chase Bank EWHC 1938 (2004)

parties to improperly manipulate the accounts and thus, violate US securities law under which the underlying transaction was governed. The claimant had argued that the underlying purpose was illegal and thus, it tainted the letter of credit itself. The Court after considering the evidence found that the underlying transaction did not breach the US Securities law. However, the Court recognized that such an exception in law existed and stated that:

> "the Court ought not and will not lend its aid to enforce a contract, a security or something akin to a security for a contract, where the underlying purpose of that contract is contrary to the law of a friendly foreign state where performance is to occur and the gravity of that unlawfulness is such as to engage public policy considerations."[232]

Thus, the Court recognized that the letter of credit did constitute security for the underlying contract would be restrained if it was established that the underlying contract was illegal as per the law where the performance of contract was to occur.

It also appears to be the right conclusion in as much the banking system cannot become vehicle for carrying out illegality. The insulation of banks from underlying transaction exists to ensure that the reputation of the banks are not sullied but it in itself cannot mean that parties engaging in illegality can utilize the machinery of banks for their ends. Also, in certain situations, banks could expose themselves to penal sanctions for abetting illegality[233].

IV. CONCLUSION: BROAD VIEW OF THE RESTRICTIVE APPROACH

In sum, it can be said that the English Courts do not easily admit of interference with banking obligations. The Courts have consistently in its past fifty or so years of jurisprudence maintained that the letter of credit obligations have to be fulfilled upon compliant presentation of documents. The primary concern of the Courts has been that by issuing letters

[232] Mahonia v. JP Morgan Chase Bank EWHC 1938 (2004)

[233] Gerald McLaughlin, "Letters of Credit and Illegal Contracts: The Limits of the Independence principle" *Ohio St. L.J.* 49, no. 5 (1989)

of credit bank substitutes its reputation and thus, the risk of the buyer with its own name. Thus, the reputation of the bank itself is at stake if the payment obligations can be easily interfered with. In this manner, the goal of the Court has been to ensure that the payments under letters of credit continue smoothly and the beneficiary is able to receive the payment while the banks can reimburse themselves from the applicant. The overall purpose behind its formulation has been a consistent concern to safeguard trust in the banking institutions as a whole.

However, the Courts have also at the same time recognized few exceptions to such payment obligations. The most frequently invoked has been the fraud exception. However, again, the Courts have looked at the fraud exception from the perspective of the banks. The banks see their role as one confining them to facial examination of documents and to not concern themselves with the hum-drum of the underlying contract. The banks also further do not carry out any investigative activities and the Courts have consistently taken sympathetic view of the same. This is demonstrated in the specific requirement of having clear and established knowledge on the part of banks that the documents under consideration are fraudulent. In its absence, the duty of the bank has been limited only to facial compliance. Another part to this is that the party bringing an action for restraining orders is required to jump a very high hurdle of standard of proof with the interim injunction standard being that of seriously arguable case that the only realistic inference is that there is proof. Needless to say it has been very few cases where the Courts have granted such injunction.

The Courts have also insulated the banks from the disputes in the underlying transaction while considering fraud exception. This was done through the principle of autonomy. The strength of the principle lies in ensuring that every disputed contract will not spill over into banking obligations. The advantage lies here that the banks continue to function smoothly and their reputation is not impacted by the presence of contractual disputes between the

parties. This in turn ensures that the public continues to maintain their trust in the banks. Or to put it simply, English banks are seen good for their money.

The severity of the Court with respect to refusal to interfere is seen in the case of *United City Merchants*[234] where the Court refused to intervene even after it was conclusively established that the document so presented was a result of fraud. However, this case has been an outlier in terms of jurisprudence given its very unique set of facts but it speaks volumes about the restrictive view the English Courts have taken.

Another exception that the Courts have recently come to recognize is that of illegality. Albeit again, no restraining orders were passed on account of the failure of the party to prove its case. The illegality exception, though, considered in few authorities show that the Court will intervene and prevent payment if it can be shown that the illegality of the underlying contract is such that it taints the letter of credit itself.

Thus, it can be said that the English Courts as they stand today will not easily restrain payment under the letters of credit. The principle of autonomy continues to reign supreme and the Courts have embraced the formula of 'pay now, argue later'.

[234] United City Merchants v. Royal bank of Canada AC 168 (1983)

INJUNCTION AGAINST LETTER OF CREDIT UNDER INDIAN LAW

India has embraced the approach of the English Courts. In essence, Indian Courts have relied upon the earlier English judgments when deciding the question of interference with payment obligations. Therefore, the method of analysis adopted by the Indian Courts has a strong English flavor, so to speak. However, as the cases would show that the Indian jurisprudence has diverged from that of their English counterparts. It has developed its own set of exceptions and consequent principles when it comes to deciding the grant of injunction. Though, like the English Courts, the Indian Courts also consider that letters of credit and bank guarantees stand on the same footing when confronted with the question of restraining orders[235]. This chapter will discuss the various grounds and methods adopted by the Indian Courts when approaching the question of restraint of payment.

The *locus classicus* as to the approach of the Courts in relation to letters of credit remains the judgment of the Supreme Court in *Himadri Chemicals Industries v. Coal Tar Refining Company*[236]. In this case the Court was confronted with the plaintiff who was the buyer seeking restraint against the irrevocable letter of credit issued in favor of the defendant-seller on the grounds that the goods were defective and did not meet the requirements. The Court refused the grant the injunction and laid down the guiding principles in relation to grant of injunction with respect to letters of credit or bank guarantee. In the words of the Court:

> "the principles for grant or refusal to grant of injunction to restrain enforcement of a Bank Guarantee or a Letter of Credit, we find that the following principles should be noted in the matter of injunction to restrain the encashment of a Bank Guarantee or a Letter of Credit :-

[235] UP Cooperative Federation v. Singh Consultants & Engineers AIR SC 2239 (1988); Centax v. Vinmar Impex AIR SC 1924 (1986)

[236] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

(i) While dealing with an application for injunction in the course of commercial dealings, and when an unconditional Bank Guarantee or Letter of Credit is given or accepted, the Beneficiary is entitled to realize such a Bank Guarantee or a Letter of Credit in terms thereof irrespective of any pending disputes relating to the terms of the contract.

(ii) The Bank giving such guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer.

(iii) The Courts should be slow in granting an order of injunction to restrain the realization of a Bank Guarantee or a Letter of Credit.

(iv) Since a Bank Guarantee or a Letter of Credit is an independent and a separate contract and is absolute in nature, the existence of any dispute between the parties to the contract is not a ground for issuing an order of injunction to restrain enforcement of Bank Guarantees or Letters of Credit.

(v) Fraud of an egregious nature which would vitiate the very foundation of such a Bank Guarantee or Letter of Credit and the beneficiary seeks to take advantage of the situation.

(vi) Allowing encashment of an unconditional Bank Guarantee or a Letter of Credit would result in irretrievable harm or injustice to one of the parties concerned." [237]

The above guidelines did not first arise in this case but are an evolution of jurisprudence developed over the last forty years. As can be seen, in the first four guidelines the Supreme Court has recognized the autonomy principle – that is, the banking obligation ought to be seen separate and distinct from the underlying contract. However, the Supreme Court has also recognized existence of two distinct grounds under which this obligation can be interfered with, namely, the fraud exception and the ground of irretrievable injustice. This chapter examines the growth and the ambit of each of these exceptions as well as certain other issues peculiar to the Indian law.

[237] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

I. THE FRAUD EXCEPTION: EMBRACE OF THE EX TURPI CAUSA

The case of *Himadari Chemicals*[238]itself involved the fraud exception. The plaintiff-buyer had contended that the part of the shipment delivered did not meet the quality requirements as agreed in the underlying contract. This fact in turn was disputed by the defendant-seller who pointed out that the remaining consignment was not only accepted but further sold by the plaintiff and that the dispute in the underlying contract was pending before the appropriate forum. The Supreme Court heavily came against the plaintiff. After examining its submissions, it found that no case of fraud had been made out. The Court relying upon the English Courts in *Bolivinter Oil v. Chase Manhattan Bank*[239] laid down that with respect to fraud exception, "[the party seeking the injunction] *has to satisfy the court that the fraud in connection with the Bank Guarantee or Letter of Credit would vitiate the very foundation of such a bank Guarantee or Letter of Credi*t"[240]. Thus, implicitly the Supreme Court recognized that the presence of dispute would not be sufficient but the party seeking restraint must should that the fraud vitiates the entire foundation of such bank guarantee.

In one of the earliest cases where the Court was asked to interfere with payment obligation under letter of credit was *Tarapore v. VO Tractors Export Moscow*[241]. The plaintiff was the buyer and had opened an irrevocable letter of credit in favor of the defendant. However, disputes arose between the parties after the delivery of the goods was made. The plaintiff approached the Court seeking restraint of payment under letter of credit alleging that the products supplied did not meet the specification of the underlying contract. However, the Supreme Court after relying upon Halsbury's Laws of England and "Law of Bankers

[238] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

[239] Bolivinter Oil v. Chase Manhattan Bank WLR 392 (1984)

[240] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

[241] Tarapore v. VO Tractors Export Moscow AIR SC 891 (1970)

Commercial Credits" by HC Gutteridge rejected that such an allegation amounted to plea of fraud on the ground that the particulars of underlying transaction are wholly different from the banking obligations under the letter of credit. The Supreme Court quoting Halsbury's Law of England found that "*the buyer is not entitled to an injunction restraining the seller from dealing with letter of credit if the goods are defective*"[242]. By this, the Supreme Court not only recognized the principle of autonomy but also laid down that the plea of fraud must arise in relation to the encashment of letter of credit.

The Supreme Court further clarified the standard to be employed when the allegation of fraud is raised in the case of *UP Cooperative Federation v. Singh Consultants & Engineers*[243]. The case arose from the application of the Respondent-seller seeking restraint orders against the Appellant-buyer from encashing the bank guarantee provided by the Respondent in relation to performance of a contract for installation of manufacturing plant. The parties shortly after the construction had a dispute and the matter was pending before the arbitral tribunal. The Respondent sought injunction against the Appellant which was granted by the High Court. The Appellant came before the Supreme Court in an appeal arguing against the decision of the High Court that no case of fraud was established and thus, no restraint could be granted. The Supreme Court concurred with the submissions of the Appellant and found that the lower Court erred by granting an injunction on the ground that there was a serious issue to be tried in the underlying contract. The Court stated that "*In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee, there should be serious dispute and there should be good prima facie case of fraud*". The Supreme Court quoted the case of *Bolivinter Oil v. Chase Manhattan Bank*[244]as "*But the evidence must be*

[242] Tarapore v. VO Tractors Export Moscow AIR SC 891 (1970)

[243] UP Cooperative Federation v. Singh Consultants & Engineers AIR SC 2239 (1988)

[244] Bolivinter Oil v. Chase Manhattan Bank WLR 392 (1984)

clear both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer"[245]. The Court concluded that it was essential that the case established must be that of "established fraud".

The Supreme Court also was confronted with another question as to whether the same principles of law would apply in this case as would apply in relation to the bank. The Respondent had brought the application for injunction not against the bank but against the beneficiary and argued that the grant of injunction must follow. However, the Supreme Court emphatically rejected such attempts reasoning that "*the net effect of the injunction is to restrain the bank from performing the bank guarantee. That cannot be done. One cannot do indirectly what one is not free to do directly*"[246]. Therefore, the Court found that bringing injunction against the beneficiary is identical to restraining the payment being made by the bank. Again, this position is identical to that taken by the English Courts.

In another case, the High Court of Madras in *Arul Murugan Traders v. Rasthriya Chemicals*[247] where the appellant was the issuer of the bank guarantee in respect of purchases made from the respondent. The case of the appellant was that the encashment of bank guarantee ought to be restrained as the respondent had practiced fraud on the appellant. The appellant to establish its case relied upon series of documents issued by the respondent to show that they were result of forgeries so much so that they were not internally consistent and displayed multitude of discrepancies. Thus, it argued that in view of the fraud practiced by the respondent, the respondent must be restrained from encashment. The Court after

[245] UP Cooperative Federation v. Singh Consultants & Engineers AIR SC 2239 (1988)

[246] UP Cooperative Federation v. Singh Consultants & Engineers AIR SC 2239 (1988)

[247] Arul Murugan Traders v. Rasthriya Chemicals AIR Mad 161 (1986)

analyzing the documents found that the documents were not only discrepant but wholly unreliable being contradictory to each other. The Court found that:

> "When so many discrepancies have been pointed out and when plaintiff had relied upon them and was able to show that in sonic of the documents relevant lorry numbers are not there or concerned signatures are not affixed, in the background of the claim made that officers of the respondents have indulged in clandestine dealings, and that, under the disputed invoices, plaintiff had not received goods, the courts below have miserably failed to look into the prima facie case pleaded by the plaintiff. As for the claim made in para 7 of the plaint, defendants have not placed any material so far, as to how the claim made therein is beset with any incorrectness or misconception of facts."[248]

The Court thereafter concluded that "*it is quite obvious that the suit involves serious questions to be tried, and particularly, relating to the plea of fraud, which courts have invariably held as a significant factor to be taken into account, whenever a relief is claimed for interdicting the enforcement of a bank guarantee*"[249]. Put another way, the Court found that the plaintiff had showed by reference to the documents that there was a serious case of forgery of requisite documents and thereby, proceeded to restrain the payment.

Thus, as can be seen that the Indian Courts have borrowed the principle of "established fraud" directly from the English law. The Courts have refused to entertain injunctive relief either against the bank or the beneficiary on the ground of fraud until that fraud was clearly established. The test laid down by the Courts is that of fraud that vitiates the entire transaction appears to also incorporate the principle of autonomy where the Courts consistently have refused to predicate the grant of injunction upon the disputes in the underlying transactions.

I.1. DOCUMENTS FOR PRESENTATION V. UNDERLYING TRANSACTION

[248] Arul Murugan Traders v. Rasthriya Chemicals AIR Mad 161 (1986)

[249] Arul Murugan Traders v. Rasthriya Chemicals AIR Mad 161 (1986)

The debate as to what would constitute fraud, that is, whether acts under the contract would be sufficient to establish fraud have also plagued the Indian Courts. The Courts in series of decisions examining the complaints as to the underlying contract have relied upon the principle of autonomy to insulate the payment obligations of the bank.

The question of reference to the details of the underlying contract was specifically taken in the case of *General Electric Technical v. Punj Sons*[250] where the Respondent had issued unconditional performance bond in favor of the Appellant whereby the Respondent was granted a contract to complete certain services. The Appellant thereafter terminated the contract on account of non-performance by the Respondent and sought to encash the performance bonds. However, the Respondent sought restraint against such encashment on the ground that the certain advance payments under the head 'mobilisation advances' had already been made out by the Respondent and that, certain running bills had not been paid by the Appellant. On this basis, the Respondent argued that the bank guarantee could not be invoked in the entirety. However, the Court rejected the argument by stating that:

> "the Bank is not concerned with the outstanding amount payable by GETSCO under the running bills. The right to recover the amount under the running bills has no relevance to the liability of the Bank under the guarantee. The liability of the Bank remained intact irrespective of the recovery of mobilisation advance or the non-payment under the running bills. The failure on the part of GETSCO to specify the remaining mobilisation advance in the letter for encashment of bank guarantee is of little consequence to the liability of the Bank under the guarantee. The demand by GETSCO is under the Bank guarantee and as per the terms thereof. The Bank has to pay and the Bank was willing to pay as per the undertaking. The Bank cannot be interdicted by the Court at the instance of respondent-1 in the absence of fraud or special equities in the form of preventing irretrievable injustice between the parties."[251]

[250] General Electric Technical v. Punj Sons AIR SC 1994 (1991)

[251] General Electric Technical v. Punj Sons AIR SC 1994 (1991)

In effect, the Court recognized that the disputes in the underlying contract cannot be read into the payment obligations. The Court refused to entertain even the argument of partial deduction from the performance bond because the Court found that such disputes aptly belonged to the underlying contract and would thus, not in any manner affect the bank's obligation to pay.

In the case of *Ansal Engineering Projects v. Tehri Hydro Development*[252], the Appellant prayed for restraining the Respondent from encashing the bank guarantee on account of pendency of the proceedings in the underlying contract. The Appellant contended that since the dispute as to non-performance of the underlying contract is ongoing, the Respondent ought to be restrained from seeking payment under the unconditional bank guarantee given by the Appellant. However, the Court rejected the submission and reasoned that:

> "Unless fraud or special equity exists, is pleaded and prime facie established by strong evidence as a triable issue, the beneficiary cannot be restrained from encashing the bank guarantee even if dispute between the beneficiary and the person at whose instance the bank guarantee was given by the Bank, had arisen in performance of the contract or execution of the Works undertaken in furtherance thereof.
>
> …
>
> It does not depend upon the result of the decision in the dispute between the parties, in case of the breach.
>
> …
>
> The liability of the bank is absolute and unequivocal; it would thereby be clear that the bank is not concerned with the ultimate decision of a court and a tribunal in its finding after adjudication as to the amount due and payable by the petitioner to the first respondent. What would be material is the quantification of the liability in the letter of revocation. The bank should verify whether the amount claimed is within the terms of the bank guarantee or letter of credit."[253]

[252] Ansal Engineering Projects v. Tehri Hydro Development, Special Leave Petition (civil) 15878/1996

[253] Ansal Engineering Projects v. Tehri Hydro Development, Special Leave Petition (civil) 15878/1996

The above case shows the application of principle of autonomy. The Appellant's pleading that the final adjudication would reveal the final accounting between the parties was rejected in view of the fact that the bank's promise to pay was not dependent on the underlying contract and thus, the pendency of adjudication in the underlying transaction would not be accepted as a ground to interfere with bank's payment obligation.

In another case of *PV Beverages v. Global Beverages*[254], the plaintiff-buyer brought a suit for restraint of payment under the letter of credit against the defendant-seller on the grounds that the goods supplied were neither timely nor met the proper standards. The plaintiff-buyer adduced extensive evidence as to the fact that the goods were delivered late and that on account of late delivery, the plaintiff-buyer suffered losses. The plaintiff-buyer also provided evidence that the goods were defective. However, the Court rejected the submissions on the ground that the defendant-seller was contesting all such allegations and moreover, none of these allegations amounted to fraud in relation to the payment of letter of credit. The Court held that:

> "There is a dispute with regard to the delayed shipment on the part of the defendant No. 1; there is a dispute with regard to the quality of goods. None of these can be termed as fraud and, that too, fraud of an egregious nature which is the requirement for carrying out an exception to the usual practice of not injuncting any bank guarantees or letters of credit."[255]

Thus, it can be seen that disputes in the underlying transaction as to delay in supply or defect in the goods would be sufficient to amount to fraud.

In the case of *Gujarat Maritime Board v. L&T Infrastructure Development Projects*[256], the Supreme Court was confronted with the situation where the appellant sought restraint against

[254] PV Beverages v. Global Beverages 148 DLT 68 (2008)

[255] PV Beverages v. Global Beverages 148 DLT 68 (2008)

[256] Gujarat Maritime Board v. L&T Infrastructure Development Projects, Civil Appeal no. 9821/2016

the respondents on the ground that since the underlying transaction stood cancelled by the Respondent, the payment obligation of the bank under the bank guarantee ought to be restrained. However, the Court found that the bank guarantee was couched in unconditional terms and stated that:

> "It is contended on behalf of the first respondent that the invocation of Bank Guarantee depends on the cancellation of the contract and once the cancellation of the contract is not justified, the invocation of Bank Guarantee also is not justified. We are afraid that the contention cannot be appreciated. The bank guarantee is a separate contact and is not qualified by the contract on performance of the obligations. No doubt, in terms of the bank guarantee also, the invocation is only against a breach of the conditions in the LoI. But between the appellant and the bank, it has been stipulated that the decision of the appellant as to the breach shall be absolute and binding on the bank."[257]

As can be seen the Supreme Court again refused to go into the details of the underlying transaction and considered only the bank guarantee which stipulated that the representation of the Respondent as to the breach of contract would be sufficient to trigger payment obligations.

In another case of *Adani Exports Limited v. Marketing Service Incorporated*[258] the Court was confronted with allegation of fraud in relation to payment under letter of credit. The plaintiff who was the buyer contended that the terms of credit required that shipment shall be completed by 5th June 2001. It contended that the bill of lading presented by the defendant-seller bearing the date 5th June 2001 was false because the vessel carrying the goods did not reach the port till 21st June 2001. Therefore, the plaintiff contended that a clear case of fraud was established. The High Court agreed with the submission of the plaintiff and found that such conduct constituted as a fraud because the terms of credit would require that the date of shipment ought to have been prior to 5th June 2001.

[257] Gujarat Maritime Board v. L&T Infrastructure Development Projects, Civil Appeal no. 9821/2016

[258] Adani Exports Limited v. Marketing Service Incorporated AIR Guj 257 (2005)

In this case, the plaintiff was able to present necessary documentary evidence to show that the bill of lading cannot be relied upon in view of the late arrival of the ship upon which the goods were purportedly loaded. Thus, the Court found that the strong case of fraud was established and thereby, restrained the letter of credit.

As can be seen, the Courts have at some length analyzed the details of the underlying transaction, yet, however, in their reasoning have categorically rejected to form its basis of reasoning upon the details of disputes in the underlying contract. At all times, the Courts have emphasized the autonomy principle and thereby, insulating the bank guarantee or the letter of credit from the disputes in the sale contract.

I.2. KNOWLEDGE OF BANK

The question as to what role knowledge of bank plays in relation to grant of restraining order arose in the case of *United Commercial Bank v. Hanuman Synthetics*[259]. In this case, the negotiating bank had released the payment to the seller and the issuing bank raised no objection when it received the documents. However, the seller upon receipt of the goods refused to release the payment and brought a suit seeking injunction against payment on the grounds that the goods did not conform to the description in the documents and that they were of inferior quality. By this stage, the issuing bank refused to honor payment to the negotiating bank. The negotiating bank as an appellant appealed the order of restraint given by the lower court on the grounds of principle of autonomy and that, in any event, it had no knowledge of fraud at the time of payment. The Court vacated the injunction on the ground that there was no fraud amounting to restraint of payment and that the negotiating bank had no knowledge of fraud when it paid to the seller. The Court stated that:

[259] United Commercial Bank v. Hanuman Synthetics AIR Cal 96 (1985)

> "Whether the goods that have been delivered are of merchantable quality or not or whether the goods are up to the contract or not or whether they are of the specified quality or quantity cannot be gone into by the bank. Similarly, the question whether the goods correspond with the description is also a question that must be resolved by the buyer and the seller in an appropriate proceeding. …
>
> This is not a case of established fraud to the knowledge of the Bank. This is simply a case of contractual dispute between the buyer and the seller in which the rights and wrongs are not clear. The dispute has arisen out of a contract of sale and delivery of goods. …. Bank after accepting the documents cannot withhold payment under the irrevocable letter of credit on that account. Its obligation to pay is quite independent of that dispute. The Court cannot also prevent the Central Bank [Issuing Bank] from honouring its obligation to pay by an order of injunction merely because an allegation of fraud has been made. If such practice is allowed to develop, the opening of irrevocable letter of credit will become meaningless and trust in international commerce and banking would be irreparably damaged."[260]

In this manner, the Court vacated the injunction and also directed the issuing bank to release the payment in favor of the negotiating bank. The essence of the reasoning of the Court was that even if the case of buyer that there exists fraud is established, there was no knowledge of such fraud on the part of the bank at the time of payment and thus, it is entitled to receive the payment.

In the corollary to the *Solo Industries*[261], the Courts in India were faced with similar claims at the hands of the same group of people who had attempted to defraud the banks in England. In the case of *Ubs Ag v. State Bank of Patiala*[262], the Supreme Court was specifically called upon to adjudicate as to whether the issuing bank, the respondents, were required to pay the negotiating bank, the appellant, after the fraud done by the buyer had been discovered.

[260] United Commercial Bank v. Hanuman Synthetics AIR Cal 96 (1985)

[261] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[262] Ubs Ag v. State Bank of Patiala Appeal (civil) 2578/2006

Briefly, Hamco group, whose other constituent was the plaintiff in the *Solo Industries*[263]case had defrauded multiple Indian banks by setting up fraudulent letters of credit. The Indian banks, who were arrayed as the respondents, had in turn contracted with the negotiating bank, the appellant, to confirm the credit. The Appellant had confirmed the credit. When the documents were presented to the Appellant, the Appellant released the payment and forwarded the documents to the Respondents. However, during the interval, the Respondent banks learnt of the fraud and refused to pay the Appellant. The Appellant in turn sought judgment against the Respondent banks to make the payment but the lower courts refused to grant such a relief. The Appellant consequently aggrieved by the orders of the lower courts approached the Supreme Court. Its contention was that at the time of payment, the Appellant had no knowledge of fraud nor the Respondent banks were aware of the fraud. And thus, it was entitled to make the payment upon presentation of confirming documents. The Court stated that:

> "If the fraud had been detected earlier and the Appellant-Bank had been informed of such fraud and put on caution prior to making payment, the Respondent-Bank may have had a triable issue to go to trial. That is not so in these three cases. In these cases, the fraud was detected after the Letters of Credit had been negotiated and hence such fraud alleged to have been committed by the constituent of the Respondent-Bank cannot be set up even as a plausible defence in the suit filed by the Appellant-Bank. The High Court, appears to have been persuaded to hold that serious triable issues arise in the present suits since the record reveals that a fraud had been committed in obtaining the Letter of Credit. Even if the constituent of the Respondent-Bank had committed fraud in obtaining the Letter of Credit, the same would not be a triable issue to decide whether the Appellant-Bank was entitled to reimbursement under the Letter of Credit before such fraud was brought to its notice."[264]

[263] Solo Industries v. Canara Bank All ER (D) 34 (2001)

[264] Ubs Ag v. State Bank of Patiala Appeal (civil) 2578/2006

Thus, the Court emphatically recognized that the knowledge of fraud was a necessary prerequisite to halt payment obligations under letter of credit. Even in cases where there is a strong case for existence of fraud, if the bank that has made the payment was not aware of such fraud on the date of payment, then it is entitled to be reimbursed.

The above position was reiterated as the necessary condition of the fraud rule by the Supreme Court in 2015 in the case of *Millenium Wires v. The State Trading Corporation of India*[265]where the Court was confronted with the prayer of the buyer, as the appellant, against the negotiating bank, arrayed as respondent, that the payment obligation under the letter of credit ought to be restrained in view of allegations of fraud against the seller. However, the Court rejected the submission of the Appellant stating that first, the case of fraud cannot be based on mere allegation and second, that the negotiating bank had already released the payment and on the date of payment was not aware of such allegation. The Court then neatly summed up the principle as:

> "It is not enough to allege fraud but there must be clear evidence both as to the fact of fraud as well as to the bank's knowledge of such fraud."[266]

Therefore, as the foregoing discussion shows the position with regard to the fraud exception in India is identical to the position in England. The clear influence of English judgments can be gleaned from multiple references to the English cases in the Indian judgments as well as the current state of jurisprudence. The Indian Courts require the party seeking restraint against payment to establish a clear case of fraud and to establish that such case of fraud was within the knowledge of the bank prior to release of the payment. In the absence of fulfillment of both these conditions, the Courts in India will not intervene on the basis of fraud.

[265] Millenium Wires v. The State Trading Corporation of India Civil Appeal 3104/2015

[266] Millenium Wires v. The State Trading Corporation of India Civil Appeal 3104/2015

II. IRRETRIEVABLE INJUSTICE: SEPARATE CONDITION OR DEPENDENT UPON FRAUD?

The Indian Courts have also crafted another exception to the payment obligations. The Courts have called this exception as that of 'irretrievable injustice'. The judgment of *Himadri Chemicals*[267] mentioned earlier specifically lists out that establishing irretrievable injustice would constitute a sufficient ground to issue an injunction against payment. In this case, the Appellant-buyer had brought suit against the Respondent-seller seeking restraint of payment under the letters of credit. The plea raised by the Appellant was that the Respondent was based out of Iran and had no assets in India and therefore, irretrievable injury would be caused if the payment under the letter of credit was released. The Supreme Court considered the facts of the case and found that the Respondent was not only contesting the proceedings regarding the underlying contract but had also furnished a bank guarantee to the lower Courts under such proceedings. It therefore found that the case of irretrievable injustice was not met. The Court formulated the test for irretrievable injustice as requiring a showing by the party claiming injunction that if the payment under the letter of credit is released, it would be impossible to recover the amount encashed in the underlying dispute.

In an earlier case of *UP Sugar Corporation v. Sumac International*[268], the Supreme Court had laid down the test for establishing irretrievable injustice. The case involved the Appellant-buyer who appealed against the High Court's decision where an injunction was granted against the Appellant from encashing the unconditional bank guarantee issued by the Respondent. The Respondent had argued that there was a case of irretrievable injustice because the Appellant was a referee was pending against the Appellant under Sick Industrial

[267] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

[268] UP Sugar Corporation v. Sumac International AIR SC 1644 (1997)

Companies (Special Provisions) Act, 1985. The Respondent contended that if the reference was actualized, the Board could take over the Appellant and restructure its finance and thus, jeopardizing the possibility of recovery in favor of Respondent. The Supreme Court relied upon the case of *Itek Corporation v. The First National Bank of Boston*[269]where the plaintiff had sought restraint against the banks to make payment to Iranian beneficiaries because of the change in government in Iran after the Iranian Revolution. The Supreme Court thereafter formulated the test for irretrievable injustice as:

> "To avail of this exception, therefore, exceptional circumstances which make it impossible for the guarantor to reimburse himself if he ultimately succeeds will have to be decisively established. Clearly, a mere apprehension that the other party will not be able to pay, is not enough."[270]

Thereafter, the Supreme Court proceeded to vacate the injunction orders. The test formulated above requires that the party claiming injunction under this exception to show *impossibility of reimbursement* if the party succeeds in the claim in the underlying dispute. Therefore, the Court by the use of the word 'impossible' has raised the standard of proof by demanding categorical supporting evidence. It has further clarified that 'mere apprehension' of inability to repay would not be sufficient to invoke this exception.

The Supreme Court in *Hindustan Steelworks v. Tarapore*[271] again reiterated that the law admitted of two exceptions to the payment obligations of the banks, namely, the fraud exception and the irretrievable injury exception. The Court was asked by the Appellants to set aside the order of the High Court granting an injunction against the payment to be made under the bank guarantee in favor of the Appellant on the ground of ongoing arbitration *interse* the two parties. The Respondents had argued irretrievable injustice if the bank

[269] Itek Corporation v. The First National Bank of Boston 566 Fed. Supp 1210 (D. Mass. 1983)

[270] UP Sugar Corporation v. Sumac International AIR SC 1644 (1997)

[271] Hindustan Steelworks v. Tarapore SCC 34 (1996)

guarantee was allowed to be paid in view of the pendency of the arbitration where the question of computation of final accounting was still pending. The Court set-aside the order reasoning that the pendency of the disputes between the parties with final accounting yet to be completed does not constitute an exception from encashment of the bank guarantee. However, the Court recognized the presence of two exceptions by holding that:

> "We are, therefore, of the opinion that the correct position of law is that commitment of banks must be honoured free from interference by the courts and it is only in exceptional cases, that' is to say, in case of fraud or in a case where irretrievable injustice would be done if bank guarantee is allowed to be encashed"[272]

Thus, the position in law is that the party that seeks restraint of a letter of credit or bank guarantee can either show fraud or can show a case of irretrievable injustice. The principle of irretrievable injustice is predicate upon the practical realities where the beneficiary may after encashing the bank guarantee may escape the bounds of law and thereby, depriving the applicant from fair adjudication of the underlying dispute as well as ability to recover any damages. However, the Supreme Court has also kept the threshold requirements high to establish irretrievable injury.

In a recent case of *BSES v. Fenner India*[273], the Court was confronted with a similar question pertaining to restraint of payment under unconditional bank guarantees. The Respondent had issued unconditional bank guarantees in view of the contract between the Appellant and Respondent. During the term of the contract, the Appellant was paid all the dues on running bills issued by it. Thereafter, disputes arose between the parties and the matter was referred to the arbitration. The Appellant during the pendency of the arbitration sought to release the bank guarantee. However, the Respondent succeeded in securing restraining orders in view of

[272] Hindustan Steelworks v. Tarapore SCC 34 (1996)

[273] BSES v. Fenner India Appeal (Civil) 955/2006

the fact that all the running bills in favor of the Appellant had been cleared and the dispute as to the underlying contract was pending. The Respondent alleged that the release of the bank guarantees at this stage would cause irretrievable injustice to the Respondent. However, the Supreme Court rejected the submission and held that there was no irretrievable injustice because bank was not concerned with the payment of running bills. The Supreme Court concluded that there can be no irretrievable injustice as the entire dispute was pending before the arbitral tribunal with Appellant duly contesting it.

However, the key point clarified by the Supreme Court in this case was the emphasis that there are only two exceptions to autonomy of payment obligations by the bank. First, being the fraud exception and second, being the irretrievable injustice exception. This position is in consonance with the previous judgments of the Supreme Court. The key advantage of this exception being that the applicant can secure restraining orders where there is a danger of the beneficiary fleeing with the money. The Supreme Court, therefore, for practical reasons has provided for protection of the applicants where there is danger of the beneficiary party absconding with the money. Also, the Supreme Court has ensured that this exception is not abused by ensuring that this exception is confined to such exceptional situations and not intervening merely because the beneficiary is a foreign party or the matter is under dispute.

However, the Supreme Court gave a different formulation of this exception in the case of *Svenska Handelsbanken v. Indian Charge Chrome*[274], where the Supreme Court was called upon by the Appellant to set aside an order of injunction given by the High Court to release the payment under the bank guarantee. The plaintiff had sought the injunction on the ground of pendency of disputes in the underlying contract and to argue that there was fraud. However, the Court rejected the submission of the plaintiff and found that the disputes did not

[274] Svenska Handelsbanken v. Indian Charge Chrome AIR SC 626 (1994)

constitute fraud for the purpose of restraining the payment obligations. It concluded that "*Mere irretrievable injustice without prima facie case of established fraud is of no consequence in restraining the encashment of bank guarantee*".

This formulation of irretrievable injustice makes this ground dependent upon establishing fraud. It requires that the party seeking restraint orders must make out a clear case of established fraud and thereafter, proceed to establish irretrievable injustice. However, it is submitted that such a formulation effectively renders both the exceptions redundant and causes confusion as to the nature of the exact test to be applied. It renders fraud exception redundant as this formulation requires a showing of irretrievable injustice after a clear case of fraud is established. This in effect is such a high standard to meet where the applicant, as in the *Adani*[275] case, after showing fraud in the bill of lading would be compelled to demonstrate an irretrievable injustice in form of fear of the party escaping the jurisdiction of the Court. Similarly, it fails to appreciate the situations like *Itek*[276] case where the danger lies in impossibility of recovery of money and not a *per se* fraud committed by the beneficiary. Therefore, it is submitted that the consistent holding of the Supreme Court in all the other cases where the two conditions are seen as distinct exceptions requiring their own set of considerations ensures greater amount of trust in the banking system. If the two conditions are made dependent upon each other, it would effectively amount to rendering any relief very difficult under either of the exceptions.

III. DUTY OF THE BANKS: WHEN THE BANK REFUSES PAYMENT?

Indian Courts have also faced with situations where the banks on their own or at the instance of their customers have refused to release the payment to other banks or the beneficiaries.

[275] Adani Exports Limited v. Marketing Service Incorporated AIR Guj 257 (2005)

[276] Itek Corporation v. The First National Bank of Boston 566 Fed. Supp 1210 (D. Mass. 1983)

This is somewhat an odd situation when compared with England where the banks are reluctant to halt the payment after a complying presentation is made.

This issue first arose in the case of *United Commercial Bank v. Bank of India*[277] where the Supreme Court was confronted with a situation where the Appellant, that was the issuing bank, was restrained by the seller to seek reimbursement of the payments made under reserve category. The Respondent bank was the negotiating bank and had made payments to the seller 'under reserve' on account of discrepancies. The Appellant bank in turn released the payment also 'under reserve'. Thereafter, when the disputes arose between the parties, the Appellant bank requested reimbursement from the Respondent bank which in turn sought reimbursement from the seller. The lower Courts granted restraining orders against the bank on the application of the seller. The Supreme Court formulated the question as: "*Whether the Court should in a transaction between a banker and a banker grant an injunction, at the instance of the beneficiary of an irrevocable letter of credit, restraining the issuing bank from recalling the amount paid under reserve from the negotiating bank, acting on behalf of the beneficiary against a document of guarantee/indemnity at the instance of the beneficiary?*"[278] The Court answered the question against the seller and allowed the Appeal, thereby, enabling the payments to go through. The Court stated that:

> "The appellant as the issuing bank was presented with documents and asked to pay a very large sum of money in exchange for them. Its duty was not to go out and - determine by physical examination of the consignments, or employment of experts, whether the goods actually conformed to the contracts between the buyer and the seller, nor even determine either from its own or expert advice whether the documents called for the goods which the buyer would be bound to accept. The banker knows only the letter of credit which is

[277] United Commercial Bank v. Bank of India AIR SC 1426 (1981)

[278] United Commercial Bank v. Bank of India AIR SC 1426 (1981)

> the only authority to act, and the documents which are presented under it. If these documents conform to the letter of credit, he is bound to pay."[279]

The Court's reasoning was that the recall of 'under reserve' payments was within the ambit of the bank, rather, the purpose of 'under reserve' payments was that such payments were conditional. Thereafter, upon the refund between the banks must happen after the request for refund is made and that it will not be open to the banks to take defences of pendency of dispute in the underlying dispute.

In the case of *Federal Bank v. VM Jog Engineering*[280], the Supreme Court was confronted with the situation where the Issuing Bank after approving the genuineness of documents resiled away from making the payment. Briefly, the Appellant was the negotiating bank that had confirmed the letter of credit in favor of the seller on behalf of the Respondent. The seller presented the documents to the Appellant and also sought payment on bill of exchange issued by the buyer. The Appellant bank being the negotiating bank forwarded the documents to the Respondent bank for confirming the genuineness of the presentation. The Respondent bank confirmed the genuineness and thereafter, the Appellant made the payment to the seller. Thereafter, disputes arose between the seller and the buyer resulting in litigation before the Courts. Meanwhile, the Respondent bank changed its stance and refused to release the payment to the Appellant bank and the buyer successfully secured an interim injunction against the release of the payment. The Supreme Court sitting in the appeal rejected the contentions of the Respondent bank and stated that the Respondent bank being the issuing bank was in the relation of principal and agent with the negotiating bank. It continued that till the negotiating bank follows the instructions of the issuing bank strictly, it is entitled to payment. Therefore, the Supreme Court concluded that since the Appellant being the

[279] United Commercial Bank v. Bank of India AIR SC 1426 (1981)

[280] Federal Bank v. VM Jog Engineering Appeal (civil) 5626/2000

negotiating bank had taken prior approval from the Respondent, it was no longer open to the Respondent to contend against the release of the payment. The Supreme Court concluded that "*The issuing Bank as principal may ratify the acts of its agent, the correspondent bank which is its agent and by doing so, relieve the correspondent bank of a liability it would otherwise have*"[281].

Similarly in the case of *Access Maritime Corporation v. Syndicate Bank*[282], the Appellant had a bank guarantee in its favor issued by the Respondent bank. The Appellant invoked the payment under the bank guarantee which was duly processed by the bank and the bank was agreeable to release the payment. The applicant filed a suit for injunction against the payment and brought an application for restraint. The lower Court declined to interfere and refused to grant the payment. However, the bank completely changed its stance at the behest of its customer and refused to release the payment. The Court found this change of stance by the bank at the behest of its customer as reprehensible and directed the bank to forthwith release payment calling the conduct of the bank as malafide. The Court stated:

> "Respondent no.1 Bank accepted the invocation of Bank Guarantee and responded to the communication of the petitioner by stating in letter dated 8th October, 1997 that the claim was under process. Thereafter on 10th October, 1997 the Bank was willing to remit the amount of US $ 15,700 but completely changed its stand and outright rejected the claim of the petitioner by communication dated 18th November, 1997. This is clearly a malafide approach as the respondent Bank obviously acted on the initiative of respondent no.2 by declining to honour the Bank Guarantee which it had no jurisdiction in law to do. … The respondent could not in law refuse to honour the statutory obligations and deprive the petitioner of its right to invoke the Bank Guarantee on the basis of the settled law by the Supreme Court which has already been referred to."[283]

[281] Federal Bank v. VM Jog Engineering Appeal (civil) 5626/2000

[282] Access Maritime Corporation v. Syndicate Bank 79 DLT 657 (1999)

[283] Access Maritime Corporation v. Syndicate Bank 79 DLT 657 (1999)

As can be seen, the Court took a strong view against the bank's voluntary refusal to release the payment especially after the fact that it had determined that a compliant presentation had been made. The Court found that it was the duty of the bank to honor its payment obligation irrespective of pendency of dispute or the request of the customer once it had decided that the presentation was compliant.

In a very strange case of *Alliance Biotech v. State Bank of India*[284], the High Court of Himachal Pradesh was confronted with a situation where the buyer had provided a no objection to release of payment under the letter of credit and found the documents to be in order. But the issuing bank refused to honor the presentation. The brief facts of the case are that the petitioner was the seller and had provided goods to the buyer. The buyer through Respondent no. 2 bank had issued letters of credit in favor of the seller. The Respondent no. 1 was the confirming bank. The petitioner presented the documents before the expiry date to the Respondent no. 1 which found the documents in order. However, the Respondent no. 2 bank, that is, the issuing bank rejected the presentation alleging discrepancies. The buyer meanwhile learnt of the controversy and stated that the documents were in order and the payment be released. However, the issuing bank refused to do so. Before the Court, the issuing bank took the stance that the documents presented contained various discrepancies and thus arguing that no complying presentation had been made. However, after examining the evidence, the High Court found that it was the issuing bank that had engaged in dubious acts by backdating the letters and presenting a different story of the events. The Court specifically noted that the issuing bank had "cooked up a story at a later stage … that it appears that some officials of the [issuing bank] have virtually forged and fabricated documents to deny the legitimate dues of the [seller] and the [confirming bank]"[285]. The

[284] Alliance Biotech v. State Bank of India CWP no. 3007/2009

[285] Alliance Biotech v. State Bank of India CWP no. 3007/2009

Court directed a forthwith release of the entire payment along with interest in favor of the confirming bank. The Court also observed that:

> "I am of the considered view that the [issuing bank] has acted in a manner which is patently, arbitrary, unethical and unfair in rejected the genuine claim of the Petitioner. It is in fact, guilty of trying to fabricate and forge documents with a view to deny the legitimate claims of the Petitioner. Not only the allegations of the Petitioner but even the reply filed by the [confirming bank] show that the [issuing bank] has acted in a highly unbecoming manner."[286]

Ofcourse, this case is an exceptional case where one bank, for reasons best known to it, decided to unilaterally block payments even after the buyer had provided a no objection against the release of the payment. What makes this case interesting is that the objections were not limited to mere question of strict compliance, which would have rendered the case ordinary. But it is the specific finding by the Court that the issuing bank went as far as to fabricate documents to deny the payment. Needless to say, in such glaring facts, the issuing bank was forced to make payment along with interest. However, implicit in the judgment of the Court is that the banks are duty bound to make payments when compliant presentation is made.

The foregoing reveals that Indian Courts have had to grapple with certain situations where the banks went ahead to deprive the beneficiaries of payment either on their own as in the case of *Alliance Biotech*[287] or at the behest of their customer as in the case of *Access Maritime*[288]. The Courts in all the cases have reprimanded the banks restating that their duty is limited to assessment of compliant presentation. Consequently, the Courts have taken the view that once a compliant presentation is made, the banks have no choice but to honor their obligations.

[286] Alliance Biotech v. State Bank of India CWP no. 3007/2009

[287] Alliance Biotech v. State Bank of India CWP no. 3007/2009

[288] Access Maritime Corporation v. Syndicate Bank 79 DLT 657 (1999)

IV. CONCLUSION: WHITHER INDIA?

Indian Courts borrowed initially from the English Courts when confronted with the question of restraining payment obligations under letters of credit or bank guarantees. However, the jurisprudence of India in the last forty years or so has diverged. Unlike the English Courts that have confined themselves to very limited exceptions and have developed their jurisprudence by bringing clarity to each of these exceptions and their respective standards of proof, the Indian Courts went ahead to create separate set of exception but has failed to clearly articulate its jurisprudence. Though, there have been efforts to give the law a direction as in the case of *Himadri Chemicals*[289] where the Court specifically laid down the principles to be followed, yet, the Courts have not provided clarity as to how such determination would be made. For example, the Courts have reiterated the fraud exception but have not yet laid down the standard of proof as their English counterparts have done. This creates a lacuna in the law in as much whenever the argument of fraud is raised, the Courts do not have an identifiable standard against which to measure the evidence.

Also, invariably, the Courts have looked into underlying transaction in one case after the other. Though, in all cases, the Courts eventually have upheld the principle of autonomy and thereby have insulated the letter of credit or bank guarantee from the proceedings in the underlying transaction, yet, the tendency to go into lengthy details of the underlying transaction is unfortunate. This is because, first of all, it enables the party seeking restraint to drag out the case before the Courts utilizing the appeal machinery to frustrate the payment obligation. This is what had happened in many cases that landed before the Supreme Court where the Supreme Court vacated the interim orders given by the lower courts. Thus, it is

[289] Himadri Chemicals Industries v. Coal Tar Refining Company, Appeal (Civil) 3522/2007

incumbent upon the Supreme Court to strongly come up against the practice of reference to the underlying transaction when it comes to even assessing the question of fraud.

The departure from the English law is apparent in the formulation of the irretrievable injustice principle that appears to have been inspired from the American case of *Itek*[290]where the peculiar set of facts involving overthrow of the Iranian government led the American Courts to restrain payments flowing out of United States to Iran. It is commendable that the Supreme Court has been very circumspect in granting injunction under this principle and clarifying that the mere presence of foreign beneficiary without assets in India would not constitute a sufficient basis to proceed to grant of injunction. This opinion, it is submitted, reflects a mature response to the arguments under irretrievable injustice. The prime purpose behind this principle is that the facts should demonstrate that the beneficiary is a flight risk and that there would be impossibility of recovery after the payment is released. The Supreme Court by contextualizing this exception has breathed life into it. This exception is also beneficial for the Indian conditions where there always exists the risk of fly-by-night operators, even domestically, that would prefer to flee after encashment. In such situations, the presence of relief against a non-cooperating party or a party known to be a flight risk inspires trust in the banking system. Indian trade would be more comfortable into trading with unknown parties or foreign parties from troubled countries as long as it is aware that the money is safe and in case of any underhanded tactic by such party, they would be entitled to restrain payments.

As such, it can be concluded that the Indian Courts have crafted the exceptions to payment obligations suited to Indian needs. Both the fraud exception and the irretrievable injustice

[290] Itek Corporation v. The First National Bank of Boston 566 Fed. Supp 1210 (D. Mass. 1983)

exception enable a more trust inspiring environment where parties could be assured that their money would not be jeopardized in case the beneficiary is fraudulent or presents a flight risk.

To sum up, the principles enunciated by the Indian Courts for grant of restraint after determining a compliant presentation has been made can be stated as follows:

1. Fraud Exception
    a. The Court is required only to examine the tendered documents whether they represent fraud or forgery
        i. Such fraud or forgery is not based upon the disputes regarding the defect or merchantability of the goods in the underlying transaction
        ii. The fraud must be clear and established
        iii. In case of unconditional bank guarantee, the presence of dispute in the underlying transaction or even pendency of final accounting will not be a reason to restrain the bank guarantee
    b. The fraud must be brought to the knowledge of the banks prior to their release of payment
        i. The bank that releases the payment before it has knowledge of fraud is entitled to be reimbursed;
        ii. The bank is under no duty to investigate or examine the underlying transaction
2. Irretrievable Injustice: The party pleading irretrievable injustice must show that there is an impossibility of recovery from the beneficiary after the payment is made.
    a. The mere fact that the beneficiary is a foreign party and has no assets inside India would not itself lead to the conclusion that there is impossibility of recovery.

b. The fact that the beneficiary is contesting the case in the underlying disputes dispels the notion that the party would escape after receiving payment.

CONCLUSION

As can be seen, both the jurisdictions are steadfast in their recognition of autonomy of letters of credit. That is, both the jurisdictions have categorically recognized and accepted that the payment obligations of the banks are to be seen distinct and separate from those in the underlying transaction. Both the jurisdictions are concerned about the reputation of the banking sector. They recognize that the banks inspire trust among its customers on its ability to honor the payment obligations as and when they are required to. This trust is at the forefront of their ability to both attract customers as well as to ensure that the credit they are issuing inspires confidence. Essentially, this brings us back to the initial idea that the banks play the role of inspiring trust in the system. They substitute the risk that the buyer or the applicant may present by putting forward their own reputation that the payments would be honored. And it is this trust that the Courts have attempted to ensure is not undermined by presence of disputes between the parties. For the banks in both the countries, this is a good position. It enables them to reach out to foreign counterparts as well as to the domestic traders assuring them that their word, so to say, is as good as gold.

The Courts in both the jurisdictions recognize that the disputes between the traders are part and parcel of life. Though, no one would say that they want to get into a dispute and that each and every one would try their best to prevent it, yet, they arise. However, when these disputes arise, the trading partners attempt to safeguard their finances deposited with the bank in form of letters of credit or bank guarantees. It is here, where, the cases start to come to the Courts where the applicants seek restraining orders against encashment by the beneficiaries. It is here where the word ‘injunction’ enters the story of trust, reputation and trade.

As could be seen, English Courts do not like the word ‘injunction’ to enter this story. They have crafted the remedies in a narrow perspective. The most-cited and most discussed case of

United City Merchants reflects the extreme approach adopted by the English Courts who went so far as to refuse to issue restraining orders even after strong evidence as to the fraud in the documents is presented. Though, the case is exceptional in view that the beneficiary of the letter of credit himself was not at fault or even had knowledge of such fraud. Yet, the approach of the English Courts is epitomized in this case. The Courts would rarely interfere in payment obligations. The Courts have set the requirement of fraud as that of limited to the fraud in documents and further qualified it with the requirement that such fraud must be clearly established. In case, this fraud is not brought to the attention of the banks prior to release of the payment, then, in such case, the applicant would no longer be entitled to restrain the banks. The upshot of all this is that the party that seeks restraint is required to overcome a very high hurdle. It must convincingly show to the Court that there is a clear established fraud to the knowledge of bank *prior* to the payment is made. The Courts have further consistently maintained this view over the last forty or so years in respect of both the letters of credit and bank guarantees. Thus, in many ways, a payment obligation taken by an English bank is 'bulletproof'. The sellers are always assured of payment and that the banks continue to present the aura of respect and trust.

The Indian Courts similarly have expounded the fraud exception in restrictive terms. Rather, a reference to early cases reveals a strong presence of the English law and cases from where the Indian Courts have liberally borrowed. The Indian Courts have also recognized that the fraud exception must operate separate and distinct from the underlying transaction. And that it is incumbent upon the party claiming fraud to show that such fraud was clearly established and was well within the knowledge of the banks *prior* to the release of payment. So far, Indian story is almost verbatim of the English story. However, this is where the Indian jurisprudence starts to diverge. The English Courts after articulating the fraud exception have continued to develop this exception. The subsequent cases have shown the growth of

jurisprudence in the direction of developing the standard of proof under which the evidence would be appreciated. On the contrary, the Supreme Court of India and the various High Courts have remained confined to the formulation of the principle of clear and established fraud without expounding on the standard of proof that the lower Courts must apply. Though, in clear cases like *Adani Exports* where it was incontrovertibly established that the bill of lading was forged, the Court proceeded to grant an injunction, but in other cases, there is a clear tendency of the Court to rush into the facts of the underlying transaction to examine presence of fraud. Thus, this absence of clear standard of proof as well as the tendency of the Courts to examine underlying transaction has stagnated the evolution of Indian jurisprudence. This is especially harmful in view that the parties that reach Supreme Court are able to show that the fraud is not established but only after suffering restraint orders for many years by the lower Courts.

However, for the purpose of understanding the valuable idea of trust, it is a welcome position that the Courts in both the jurisdictions have refused to entertain injunctions except only when very high standards are met. This ensures that the banks are consistently able to project their reputation across the world as reliable payers. This not only ensures an improvement in the business of the banks themselves but also benefits the economy as a whole. The benefit of the fraud exception is that it further strengthens the belief in the banking system. By recognizing that the banking system will not assist fraudsters, the Courts in both jurisdictions have taken the right step of ensuring that the trust and credibility built by banks will not be sullied by fraudsters.

With respect to India, given its geography where it is surrounded by multitude of failed or failing states, it is but natural that the Courts have developed another exception to the payment obligations. The Courts have called this exception as that of ‘irretrievable injustice’ where the party claiming restraint has to show that the beneficiary would abscond, or to use

plain English, vanish from the face of the earth after encashing the payment. But the Courts though have recognized this exception but have also been circumspect in ensuring that the exception does not get too broad to enable parties to seek restraints on the ground that the beneficiary is a foreign party. The Courts have, therefore, specifically rejected such positions and taken a more holistic approach of examining the conduct of the beneficiary, as in, whether it is appearing before the Courts and contesting the proceedings in the underlying transactions. This holistic approach protects the foreign parties from suffering restraint orders merely on the ground that they are foreign parties. Furthermore, such holistic approach inspires the traders to engage with parties coming from dubious jurisdictions knowing fully well that if such parties decide to *vanish* then, adequate remedy in form of the injunctive relief is available. What is most important here is that, the trade also benefits as this exception applies against the domestic parties too. That is, if the party seeking restraint can show that the domestic party is unreliable and that there is clear case of it escaping justice, then, such restraining orders can be sought in relation to domestic parties too.

When again looking from the perspective of trust, such an approach is commendable. It enables the traders in India to engage with small or obscure parties in India or in its neighborhood. This is because, if such party decides to unfairly take advantage of letters of credit or bank guarantee with the motive to abscond, then, the applicant does indeed have the remedy to seek restraint orders. On the other hand, it is beneficial for small parties as well who in absence of such would not be able to convince established traders to enter into a trading relationship.

In the end, it can be seen that both the jurisdictions developed their legal principles in light of the particular circumstances their Courts faced. Though, both England and India started from the same set of principles forty years ago, yet, their jurisprudence and approach to such cases

have diverged. But in spite of this divergence, the position remains similar in both the jurisdictions: Injunctions against the Letters of Credit are an exception and not the rule.

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